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Credit
Research
Center

MONOGRAPH NO. 24
CONSUMER BANKRUPTCY STUDY
VOLUME II
Personal Bankruptcy: Causes, Costs and Benefits

Krannert Graduate School of Management – Purdue University

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CONSUMER BANKRUPTCY STUDY

VOLUME II

Personal Bankruptcy: Causes, Costs and Benefits

A. Charlene Sullivan

CREDIT RESEARCH CENTER

1982

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TABLE OF CONTENTS

Page

LIST OF EXHIBITS iv

PREFACE vi

Abstract ix

CHAPTER 1: PROFILE OF THE PETITIONER FOR PERSONAL BANKRUPTCY . . . 1

I. Overview 1

II. Demographic Characteristics 1
A. Position in the Life Cycle 1
B. Age 2
C. Marital Status 5
D. Education 5
E. Employment 8
F. Home Ownership 11

III. Family Income 17

IV. Summary 17

FOOTNOTES 19

CHAPTER 2: THE ROUTE TO BANKRUPTCY 20

I. Overview 20

II. Petitioners' Use of Nonmortgage Debt 20
A. Amount of Nonmortgage Debt 21
B. Types and Sources of Nonmortgage Credit 24
1. Unsecured Consumer Credit 24
2. Secured Credit 30

III. Petitioners' Perception of Causes of Bankruptcy 34
A. Medical Bills 39
B. Marital Problems 39
C. Excess Use of Credit 40
D. Loss of Employment 41
E. Filing to Avoid Certain Creditors 41

IV. Record of Previous Bankruptcy 43

V. Petitioners' Information About Bankruptcy Procedures . . . 49
A. Source of Information 49
B. Use of Legal Assistance in Bankruptcy 52
C. Knowledge of Chapter 13 (Reorganization) 52
D. Knowledge of Ability to File for Bankruptcy in the Future 54
E. Knowledge of the Effect of a Bankruptcy on the Credit Report 57

Page

VI. Alternatives to Bankruptcy 57

VII. Summary 61

FOOTNOTES 63

CHAPTER 3: THE COSTS OF BANKRUPTCY 64

I. Overview 64

II. Expected Loss of Assets 66

III. Estimated Change in Wealth From Bankruptcy 70
- A. Factors Related to Changes in Wealth 77
  - 1. Asset Retention Ratio 77
  - 2. State exemption levels 77
  - 3. Before-tax family income 80
  - 4. Ability to repay debts 82

IV. Ability to Obtain Credit After Bankruptcy 85

V. Summary 87

FOOTNOTES 92

CHAPTER 4: EFFECT OF THE LEVEL OF ASSET EXEMPTIONS AND BANKRUPTCY JUDGES 93

I. Overview 93

II. Exemption Levels 95
- A. Debtors' Choices Between Federal and State Exemptions 95
- B. Family Income 97
- C. Total Assets 98
- D. Other Effects 98
- E. Ability to Repay 101

III. Effect of the Presiding Judge 103

IV. Summary 107

FOOTNOTES 110

CHAPTER 5: EFFECT OF THE PROPOSED CHANGE IN THE FEDERAL BANKRUPTCY LAW ON PETITIONERS FOR BANKRUPTCY 111

I. Ability to Repay 112

Page

II. Demographic and Economic Characteristics 113
  A. Life Cycle 113
  B. Before-Tax Family Income 113

III. Causes of Bankruptcy 119

IV. Alternatives to Bankruptcy 128

V. Recurrent Bankruptcy 131

VI. Summary 131

FOOTNOTES 134

CHAPTER 6: CONCLUSIONS AND IMPLICATIONS 135

I. Characteristics of Chapter 7 Petitioners 135

II. The Costs of Bankruptcy 136

III. Effect of 1978 Bankruptcy Reform Act on Costs of Bankruptcy 138
  A. Property Exemptions 138
  B. Stay on Collection Activity 139

IV. The Market's Response to the Bankruptcy Act 140

V. Proposed Changes in Bankruptcy Legislation 142

APPENDICIES

Appendix A: Selected Bibliography 145
Appendix B: Personal Interview Questionnaire 151
Appendix C: Data Recorded From Chapter 7 Petition 172

LIST OF EXHIBITS

Exhibit — Page

1-1 Position in Life Cycle . . . 3
1-2 Age of Head of Household . . . 4
1-3 Marital Status . . . 6
1-4 Education of Head of Household . . . 7
1-5 Employment Status of Bankrupt Consumers . . . 9
1-6 Occupation--Head of Household . . . 10
1-7 Home Ownership . . . 12
1-8 Real Estate Value . . . 13
1-9 Mortgage on Principal Residence . . . 14
1-10 Annual Before-Tax Family Income . . . 16

2-1 Nonmortgage Instalment Debt Outstanding (Including Credit Card Outstandings) . . . 22
2-2 Total Instalment Debt to Pre-Tax Annual Family Income . . . 23
2-3 Unsecured Debt as Percent of Total Debt (Nonmortgage, Nonbusiness Debt) . . . 25
2-4 Sources of Unsecured Nonmortgage Instalment Credit . . . 28
2-5 Type and Number of Creditors . . . 29
2-6 Use of Unsecured Debts by Income Groups . . . 31
2-7 Nonmortgage Secured Debt . . . 33
2-8 Important Factors Leading to Bankruptcy . . . 35
2-9 Most Important Factors Leading to Bankruptcy . . . 37
2-10 Reasons for Bankruptcy (Most Important) . . . 38
2-11 Creditors that Petitioner Did Not Want to Repay . . . 42
2-12 Record of Previous Bankruptcy . . . 44
2-13 Most Important Cause of Bankruptcy for Those Who Had Filed Bankruptcy Before . . . 46
2-14 Sources of Unsecured Nonmortgage Instalment Credit . . . 48
2-15 Source of Idea to Declare Bankruptcy . . . 50
2-16 Petitioners' Use of Legal Assistance . . . 51
2-17 Knowledge of Chapter 13 Procedures . . . 55
2-18 Knowledge of Ability to File for Bankruptcy Again . . . 56
2-19 Knowledge of Impact of Bankruptcy on Credit Report . . . 58
2-20 Alternatives to Bankruptcy . . . 60

3-1 Exempt Assets As Percent of Total Available Assets . . . 67
3-2 Expected Cost of Bankruptcy Effect on Asset Ownership . . . 69
3-3 Asset Exposure by Exemption Levels . . . 71
3-4 Dollar Value of Gain from Bankruptcy . . . 75
3-5 Percent Distribution of Change in Net Worth for Given Level of Net Worth Before Bankruptcy . . . 76
3-6 Percentage Change in Net Worth . . . 78
3-7 Gain from Bankruptcy . . . 79
3-8 Gains from Bankruptcy by Exemption Levels . . . 81
3-9 Gains from Bankruptcy by Income . . . 83
3-10 Gains from Bankruptcy by Debt Portfolio Characteristics . . . 84
3-11 Gains from Bankruptcy by Ability to Repay Debts . . . 86
3-12 Difficulty in Getting Credit in the Future . . . 88
3-13 Source of Information About Future Credit Availability . . . 90

LIST OF EXHIBITS (continued)

Exhibit Page

4-1 Annual Before-Tax Family Income. 99
4-2 Exemption Levels and Total Assets of Petitioner. 100
4-3 Ability to Repay Exemption Level 102
4-4 Chapter 7 as Percent of Total Personal Bankruptcies. 104
4-5 Ability to Repay by Court District 106
4-6 Income Groups by Court Districts 108

5-1 Life Cycle 114
5-2 Marital Status 115
5-3 Total Before-Tax Family Income 117
5-4 Occupation-Head of Household 118
5-5 Education-Head of Household 120
5-6 Expected Future Income 121
5-7 Most Important Causes of Bankruptcy. 122
5-8 Most Important Reason. 123
5-9 Ability to Repay Debts in 36 Months by Attitude Toward Paying Creditors. 125
5-10 Actions Taken by Creditors to Collect Loan 126
5-11 Debt Portfolio Characteristics 127
5-12 Sources of Unsecured Credit. 129
5-13 Alternatives to Bankruptcy Considered and Tried. 130
5-14 Attitude Toward Filing for Bankruptcy Again. 132

PREFACE

This study had been prepared by the staff of the Credit Research Center (CRC) in cooperation with Arthur D. Little, Inc. (ADL) and Opinion Research Corporation (ORC). The study was financed by the Coalition for Bankruptcy Reform, a group made up of a broad cross section of the consumer credit industry and associated organizations. About five-sixths of the funding was used to cover the costs of the field survey of consumers filing for Chapter 7 in 20 judicial districts in ten states. The remaining one-sixth was provided to CRC to help defray the incremental costs of preparing the study. The Credit Research Center is within the Krannert Graduate School of Management, Purdue University.

When a study is funded by an industry group, one must be prepared to hear charges of bias "in favor of" the industry. Such charges are, of course, based on a false premise that what is good for the industry is bad for consumers and vice versa. As we have shown in this and a number of earlier research studies, issues of public policy in the areas of consumer and mortgage credit involve trade-offs--more accurately, subsidies or wealth transfers--between one group of consumers and another. In this competitive market, one could not bias a study "in favor of" the credit industry *per se*, even if that were the objective.

Nonetheless, the research was structured in a manner to avoid potential bias, or the taint of bias. The questionnaire to be administered to debtors was prepared by three members of the CRC staff: Robert W. Johnson, Richard L. Peterson, and A. Charlene Sullivan. That and subsequent drafts were modified on the basis of suggestions from Dr. Edwin B. Cox and Blair C. Shick of ADL and Sandra M. Spies of ORC. Nobody from the credit industry or associated organizations saw the questionnaire until after it was in the field.

Edwin Cox and Blair Shick of ADL had prime responsibility for designing the sampling plan, both in the selection of the states and judicial districts and in the procedures to follow in selecting consumers to be interviewed. They also had the task of gaining the cooperation of the judges in each of the districts and that of the attorneys appearing in the courts. CRC staff had no contact with any of the many judges who cooperated in this research effort.

The interviewing of the debtors and the gathering of data from the petition was the sole responsibility of the staff of ORC. The important functions of coding and tabulating the data were entirely the duty of ORC staff. The raw data in the form of the questionnaires and petition data forms remain in Princeton with ORC, both to separate the data gathering and data analysis functions and to protect the privacy of the consumers interviewed.

The analysis of the data was the responsibility of the staff of CRC. ORC provided us with a computer tape encoded with the data on the 1,199 cases sampled. With the aid of able graduate research assistants (Swaminathan G. Badrinath and Dan A. Black) we prepared the tables provided in this and the following monograph, as well as many supplementary tables used in the analysis of the data. Members of the credit industry had no part in this analysis, nor did any of the CRC staff have a role in drafting or reviewing the proposed amendments to the Bankruptcy Act of 1978 proposed by the Coalition.

This study does not relate to changes in bankruptcy legislation introduced by the Bankruptcy Act of 1978. Instead, this study provides an empirical investigation and analysis of a public policy established in 1898 under the Bankruptcy Act passed in that year. At that time Congress decided that consumers could file for bankruptcy without regard to their ability to pay some portion of their debts out of future income. That policy has remained essentially unchanged since that time. Whether that is a sound policy in the very different credit markets of 1982 is a value judgment. The empirical data and analysis provided in this monograph provide a basis of reaching that value judgment.

We are greatly indebted for the highly professional and constructive contributions of Ed Cox and Blair Shick at ADL and Sandy Spies and Carole Hewitson of ORC. Not only are they experts at what they do, but they are delightful to work with. We also thank our secretarial staff--Marty Lynch, Cindy Overman and Betty Schoenhals for their skills and patience. Finally we thank each other for carefully reviewing and editing the numerous drafts of each of the chapters.

Robert W. Johnson
Richard L. Peterson
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PERSONAL BANKRUPTCY

CAUSES, COSTS, AND BENEFITS

A. Charlene Sullivan*

Abstract

The option to use the court system as a means of reducing one's debts is available to all consumers.[1] Whether a consumer exercises that option is a function of the expected benefit (reduction in debts) relative to the expected costs of bankruptcy (loss of assets, reduced access to credit markets, transactions costs). This monograph, the second of two monographs prepared for the Consumer Bankruptcy Study by the Credit Research Center, contains an analysis of a sample of households who had petitioned for a straight liquidation of debts under Chapter 7 of the Bankruptcy Act. Included in Chapter 1 of the monograph is a comparison of the study sample with a national sample of households who used consumer instalment credit. This comparison allows us to identify the distinguishing demographic and economic characteristics of the sample of petitioners. In the second chapter we trace the most traveled paths to bankruptcy and evaluate the role played by unemployment, personal problems, and creditor actions as causes of bankruptcy. In addition, alternatives to bankruptcy the petitioners were familiar with or had

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*Senior Research Scholar, Credit Research Center, Purdue University. This monograph was prepared with the assistance of S. Badrinath. Debra A. Drecnik, Robert W. Johnson and Richard L. Peterson provided helpful suggestions.

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tried and their sources of information about the bankruptcy process are evaluated. The controversial role played by lawyer advertising of bankruptcy services is given particular attention. In Chapter 3, petitioners' evaluations of some of the expected costs of bankruptcy are summarized. Included in those costs are their expected loss of assets and future ability to obtain credit. The benefits gained from taking a straight liquidation bankruptcy are equal to the change in the household's net worth resulting from the write-down of liabilities and loss of assets. In Chapter 3, this benefit of bankruptcy is calculated for each petitioner and analyzed to determine the characteristics of petitioners receiving the greatest benefits from bankruptcy. In Chapter 4, the cross-sectional relationship between the total value of assets exempted from liquidation in a bankruptcy as specified by state or federal law and the characteristics of households petitioning for bankruptcy is examined to address the question of whether the level of exemptions has any effect on the number and characteristics of persons expected to file for bankruptcy. In addition, there is considerable variation across bankruptcy court districts in terms of the incidence of liquidation bankruptcy relative to reorganizations (Chapter 13). We selected the eight court districts in our sample that were on the extreme ends of the continuum of the proportion of personal bankruptcies that were Chapter 7. We analyze the characteristics of petitioners from those court districts where the proportion of Chapter 7 cases was lowest relative to those where the proportion of Chapter 7s was highest to determine the effect of the judge on the bankruptcy phenomenon.

Finally, legislation has been proposed which would require that a straight liquidation bankruptcy be available only to those consumers who could not repay a reasonable portion of their debts out of anticipated future income. A consumer seeking relief from debts could obtain court protection from creditors under Chapter 13 of the Bankruptcy Act and repay outstanding debts over a specified period according to a schedule approved by the bankruptcy judge. Otherwise, the consumer could renegotiate payments with creditors or seek the assistance of a credit counseling agency. In Chapter 5, the characteristics of petitioners in our sample who would have been denied bankruptcy under the conditions of the proposed legislation are examined.

This study was not designed or intended to measure directly the extent to which the rapid increase in the number of personal bankruptcies since 1980 could be attributed to the changes made in The Bankruptcy Reform Act of 1978 and put into effect in October 1979. However, the study was intended to show how the decision to file personal bankruptcy is reached and how the specifics of the law governing the process affect that decision. The results of this study suggest that the incidence of personal bankruptcies can be linked with facets of the new bankruptcy law that reduced the expected cost of bankruptcy, especially for middle and upper-income families.

CHAPTER 1

PROFILE OF THE PETITIONER FOR PERSONAL BANKRUPTCY

I. Overview

A creditor must estimate the probability of default or bankruptcy for a particular consumer or group of consumers in order to price credit correctly. That estimation is typically facilitated by comparisons of the characteristics of proven good and bad credit customers. Differences in demographic and economic characteristics of the two groups of customers are used to assess the credit quality of new applicants for credit. Using this practice as a basis, we compared the characteristics of the sample of petitioners for debtor relief (called the petitioner sample) with the characteristics of a national sample of households with consumer debt outstanding (called the debtor sample). The national survey data were collected in 1977 in a survey of consumers' views on consumer credit.[2] To make comparisons of dollar values in the following analysis, the 1977 data were adjusted to reflect price level changes that had occurred between 1977 and 1981.[3] In the following sections we highlight the differences in the demographic and economic characteristics of the two groups.

II. Demographic Characteristics

A. Position in the Life Cycle

Past studies of consumers' use of nonmortgage instalment credit have shown a relationship between a household's position in the life cycle and the amount of consumer debt the household will have outstanding. Young families have a greater demand for credit than mature families because family income is generally low during the family-formation years. Also, young heads of household have less job security and are more vulnerable to layoffs in periods of unemployment. In addition, they have fewer financial assets and are less able to handle unexpected expenses. Thus, one would expect the incidence of bankruptcy to be high among young families with small children. The life cycle characteristics of the petitioner and debtor samples are shown in Exhibit 1-1.

The distributions of the two groups classified by position in the life cycle were significantly different at the ten percent level of confidence. The petitioner sample was made up primarily of families with a head of household younger than 45 years of age. Relatively more of the petitioners than the debtor sample were young and married with young children. Relative to the petitioners, the debtors were more likely to be 45 years old or older, married and with no children at home. Thus, as expected, the consumers who get into financial distress are most likely to be in the early stages of the life-cycle when their need for credit is highest. Almost 30 percent of the petitioners were single, with or without children. Only 15 percent of debtors were in this category.

B. Age

The petitioner head of household was most likely to be between the ages of 25 and 34 (Exhibit 1-2). Approximately 21 percent of both the petitioner and the debtor samples were younger than 25 years old. Only about seven percent of the petitioners were 55 years old or older in contrast to about 22 percent of the debtor sample. The petitioner head of household was almost twice as likely as the debtor head of household to be between the ages of 25 and 34. Petitioners and debtors under 25 years of age occurred with almost identical frequency.

EXHIBIT 1-1

POSITION IN LIFE CYCLE

	1981 Bankruptcy Study*		1977 Consumer Credit Survey**	
Less than 45 yrs. old		69.5%		52.9%
Single - no children	14.9%		7.9%	
Married				
No children	11.3		10.1	
Children <6 yrs. old	29.1		21.3	
Children >6 yrs. old	14.2		13.6	
45 yrs. old or older		14.4		36.7
Single - no children	3.2		6.1	
Married				
No children	5.0		17.9	
Children	6.2		12.7	
Single (any age) with children	14.8	14.8	6.9	6.9
Missing	1.3	1.3	3.3	3.3
Total		100.0%		100.0%

$\chi^2 = 232.67$ Significant at the ten percent level of confidence.

---

*Based on 1199 respondents who had filed for bankruptcy under Chapter 7.

**Based on 1524 respondents who had positive amounts of instalment or credit card debt.

Totals may not add to 100 percent due to rounding.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study; 1977 Consumer Credit Survey, Board of Governors of the Federal Reserve System.

NOTE: The chi-square statistic is based on a comparison of the overall distributions of life cycle characteristics not on the summary tables in the right most column for each sample.

EXHIBIT 1-2

AGE OF HEAD OF HOUSEHOLD

	1981 Bankruptcy Study	1977 Consumer Credit Survey
Under 25 years	12.3%	12.2%
25 - 34	45.0	26.0
35 - 44	24.5	20.1
45 - 54	11.0	19.2
55 - 64	5.2	15.1
65 or older	1.2	6.9
No response	.8	.4
	100.0%	100.0%

$\chi^2 = 250.80$ Significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study; 1977 Consumer Credit Survey, Board of Governors of the Federal Reserve System.

Almost half of the petitioner sample were in the 25-34 age bracket. It is likely that, due to the baby boom, a greater percentage of debtors in general fall in that age category today than is shown by the 1977 survey data.

C. Marital Status

More than half of the petitioners for bankruptcy were married (Exhibit 1-3) or living as married. This is in contrast to the debtor sample where 74 percent were married. Almost 30 percent of the petitioner sample were divorced or separated and 11 percent reported that they had never been married.

The Bankruptcy Act of 1979 made it possible for a husband and wife to file for bankruptcy jointly and double the asset exemptions allowed in some states. An analysis of the petitioners' filing status relative to marital status revealed that 71 percent of the petitioners married, separated or living as married filed for joint bankruptcy. Thus, 47.6 percent of the sample of petitioners were filing a joint petition. Twenty-two percent of married petitioners reported that the spouse had not filed for bankruptcy.

D. Education

There were striking differences in the level of education for the two groups of consumers (Exhibit 1-4). Although there was little difference in the percentage of each group which had not finished high school, a head of household in the petitioner sample was much more likely to have terminated his or her education after completing high school than a member of the debtor sample. Nineteen percent of debtor heads of

EXHIBIT 1-3

MARITAL STATUS

	1981 Bankruptcy Study	1977 Consumer Credit Survey
Married	57.1	74%
Separated	8.5	
Divorced	20.3	
Living as married	1.4	
Single - never married	10.9	
Widowed	1.8	
Other		26*
	100.0%	100%

PETITIONERS' FILING STATUS - MARITAL STATUS

Joint filing (married, separated, or living as married)	47.6%
Individual filed, spouse filed	1.6
Individual filed, spouse did not file	14.9
Individual filing, no spouse	35.9
	100.0%

*In the 1977 Consumer Credit Survey, respondents were asked to indicate whether they were married or not. No further information on marital status was obtained.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study; 1977 Consumer Credit Survey, Board of Governors of the Federal Reserve System.

EXHIBIT 1-4

EDUCATION OF HEAD OF HOUSEHOLD

	1981 Bankruptcy Study	1977 Consumer Credit Survey
Did not finish high school	24.5%	22.9%
High school graduate	32.3	17.8
Training or vocational school	7.6	19.0
Attended college courses	23.7	19.1
College graduate	6.8	15.0
Advanced college degree	2.8	5.5
No response	2.3	.7
	100.0%	100.0%

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study; 1977 Consumer Credit Survey, Board of Governors of the Federal Reserve System.

household had completed vocational or training school compared to less than eight percent of petitioners. Both groups had a large contingent that attended some college courses but relatively few in the petitioner sample had completed a bachelor's degree or an advanced degree.

E. Employment

The number of individuals filing for personal bankruptcy has historically been highly correlated with the rate of unemployment. Thus, one would expect that a large percentage of the petitioner households had suffered from an interruption in employment. However, the figures in Exhibit 1-5 indicate that 78.6 percent of petitions had been filed by households that had at least one person employed full time at the time of filing. In addition, 58.5 percent of petitioners had at least one person in the household employed continuously for the 12 months prior to filing for bankruptcy. Those households filing for joint bankruptcy were more likely to have at least one person working full time at the time of filing than those filing singly. Almost 22 percent of petitioners for joint bankruptcy had two people working full time at the time of filing. At the time the petition was filed, 72 percent of male petitioners held full time jobs and 20 percent were unemployed. Forty-one percent of female petitioners held full time jobs and 45 percent were unemployed. Male respondents who were unemployed were most likely to have been laid off or permanently disabled. Female respondents who were unemployed were most likely to have been staying at home to care for family.

The distributions of occupations for the two groups (Exhibit 1-6) show that the petitioners were considerably more likely, relative to

EXHIBIT 1-5

EMPLOYMENT STATUS OF BANKRUPT CONSUMERS

Type of Petition		One Person Employed Full-Time	Two People Employed Full-Time	At Least One Person Employed Full-Time
Single Filing	626	471(75.2%)	xxxx	471(75.2%)
Joint Filing	571	345(60.4%)	124(21.7%)	469(82.1%)
Unknown	2	?	?	2(100%)
Total	1199			924(78.6%)

NOTE: Number of Petitions with at least one person employed continuously for the preceding 12 months 702 (58.5%).

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study, Monograph 23, Chapter 3, p. 33.

EXHIBIT 1-6

OCCUPATION - HEAD OF HOUSEHOLD

	1981 Bankruptcy Study	1977 Consumer Credit Survey
Professional & Technical	7.7%	12.4%
Managerial Officials or Proprietor	7.3	14.4
Clerical	8.3	5.9
Sales	5.2	4.2
Craftsmen, Foremen	19.7	18.7
Operatives[1]	9.1	13.9
Service Workers[2]	11.1	4.7
Laborers[3]	9.5	5.1
Other (NA)	1.9	5.1
No response	20.3	15.6
	100.0%	100.0%

[1] Operatives: apprentices; auto service and parking attendants; railroad brakemen; bus drivers; bus and street railway conductors; dyers; motormen; sailors and deck hands; stationary foremen; taxicab drivers; truck and tractor drivers; welders.

[2] Service Workers: housekeepers, private household; laundresses, private household; hospital and other institutions attendants; barbers; beauticians, and manicurists; bartenders; cooks; elevator operators; foremen, fire protection; guards, watchmen, and doorkeepers; janitors; marshals and constables; policemen and detectives; porters; ushers; waiters and waitresses; crossing watchmen.

[3] Laborers: fishermen, garage laborers and car washers and greasers; gardeners, groundkeepers, farmers, longshoremen and stevedores; lumbermen and woodchoppers.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study; 1977 Consumer Credit Survey, Board of Governors of the Federal Reserve System.

the sample of debtors, to hold unskilled jobs (service, laborer). The debtors were more likely to hold professional or managerial positions than the petitioners.

In general, the data do not indicate that the petitioner sample suffered from a high level of unemployment. Most of the petitioner heads of household held unskilled jobs and about one-fifth of the bankruptcy petitions came from two-income families.

F. Home Ownership

As one might expect from the age distribution of the petitioners, few in that sample owned their home (Exhibit 1-7). Twenty-seven percent owned their residence and ten percent neither owned nor rented but were living with family members, or others. The reamining petitioners were renters. In contrast to the debtor sample, the petitioners were far less likely to own their home and much more likely to rent. The market values of the principal residence owned by the petitioners ranged from $495 to $18,000 (Exhibit 1-8). The average market value of $34,550.

All of the petitioners had mortgages on their principal residence. A large percentage (38 percent) had mortgages (first and second where applicable) that totaled less than 50 percent of the market value at the time they filed for bankruptcy (Exhibit 1-9). However, almost ten percent reported a loan-to-value ratio of greater than 100 percent. Although this result could be attributable to reporting errors on the petition, it could also be explained by under-valuation of the asset or to a real decline in the market prices of their housing. The fact that mortgage debt obligations were greater than the value of the property may have motivated the bankruptcy for this group of petitioners. The

EXHIBIT 1-7

HOME OWNERSHIP

	1981 Bankruptcy Study	1977 Consumer Credit Survey
Own home	27%	72%
Rent	63	25
Neither	10	3
No response	-	-
	100%	100%

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study; 1977 Consumer Credit Survey, Board of Governors of the Federal Reserve System.

EXHIBIT 1-8

REAL ESTATE VALUE

(FOR 319 HOMEOWNERS)

Market Value of Principal Residence	Number	Percent
$495-15,000	71	22%
$15,001-30,000	101	32
$30,001-60,000	107	34
$60,001-90,000	23	7
$90,001-120,000	7	2
$120,001-180,000	7	3
Missing	3	-
	319	100%

NOTE: Average value = $34,550

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

EXHIBIT 1-9

MORTGAGE ON PRINCIPAL RESIDENCE

(FOR 319 HOMEOWNERS)

Mortgage Debt (including second mortgage) to Market Value	Number	Percent
Less than 50 percent	120	38%
50-60 percent	15	5
61-70 percent	21	7
71-80 percent	31	10
81-90 percent	26	8
91-100 percent	42	13
Greater than 100 percent	29	9
Business bankruptcies	33	10
Missing values	2	—
	319	100%

NOTE: Average total mortgage credit outstanding for nonbusiness bankruptcies = $22,189.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

average mortgage outstanding was $22,890 and the average loan-to-value ratio was about 66 percent.

Slightly more than 25 percent of the petitioners filing a nonbusiness bankruptcy who owned their principal residence reported that they had a second mortgage. The average dollar value reported for the second mortgages was $15,123. The smallest second mortgage reported was $680 and the largest was $69,000.

The average mortgage payment for those petitioners who owned their home was slightly more than $230 per month (as was the average rental payment). This is a low monthly payment in contrast to that required on a new mortgage today. Thus, that factor did not seem to be a significant factor causing these families to take bankruptcy. Those who reported separate monthly utility expenses including heat, telephone and electricity had an average monthly utility bill of $170.

It is noteworthy that so few of the petitioners relative to debtors in general owned their own home. Home ownership is an important indicator of creditworthiness to financial institutions. Perhaps petitioners in general were perceived by financial institutions as high risk because of the lack of homeownership. Consequently, credit from these sources was limited and they resorted to the use of credit from sellers of goods and services who may not check credit reports or report to credit bureaus and take collateral. Thus, when these consumers did not strictly discipline themselves in terms of their use of credit, they got little feedback from the credit markets until they had become overextended. This path to bankruptcy will be evaluated further in Chapter 3.

EXHIBIT 1-10

ANNUAL BEFORE-TAX FAMILY INCOME

	1981 Bankruptcy Study	1977 Consumer Credit Survey*
Less than $5,000	19.8%	2.4%
$5,000 - 9,999	29.7	11.3
$10,000 - 14,999	24.7	9.3
$15,000 - 19,999	11.2	10.4
$20,000 or more	14.7	66.6
	100.0%	100.0%

*Adjusted for cost of living increase from 1977 to 1981.

$\chi^2 = 831.79$ Significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study; 1977 Consumer Credit Survey, Board of Governors of the Federal Reserve System.

III. Family Income

The average before-tax family income reported by the petitioners was about $10,400.[4] Although the bulk of the petitioners reported that at least one person in the household was employed at the time of the filing, more than 40 percent of petitioners made less than $10,000 in before-tax income (Exhibit 1-10). Only about 15 percent of the petitioner sample had family income of more than $20,000. Almost 20 percent of the petitioner sample reported annual family income of less than $5,000. Fourteen percent of the sample reported that they had received food stamps valued at an average of $126 in the month before filing for bankruptcy

In sharp contrast, the bulk of the debtor sample (67 percent) made more than $20,000 before taxes per year (adjusted for inflation since the time of the 1977 survey). Only 14 percent made less than $10,000 and only about two percent made less than $5,000 per year before taxes. The distributions of the two groups by income category were significantly different at the ten percent level of confidence.

Although the average income of the petitioner sample was very low, the petitioners were generally optimistic about their income prospects. Fifty percent expected their income to increase by the end of the year from its level at the time of the filing and 35 percent expected their income to remain about the same throughout the year. Twenty-two percent expected their income to increase by more than ten percent.

IV. Summary

This analysis of the demographic and economic characteristics of the petitioner sample indicates that the petitioners were primarily heads of household of young families. The head of the petitioner household was most likely to have a high school degree, be employed in an unskilled labor position, and report family income of $5,000 to $10,000 per year. At the time of the filing the bulk of petitioner households had at least one person employed full time and expected family income to increase in the year following their filing date. Less than 30 percent of the petitioners owned their own home. Almost 15 percent had received food stamps in the month before they petitioned for bankruptcy.

In contrast to the national sample of users of consumer instalment credit, the petitioners were younger, and were less likely to be married at the time they filed for bankruptcy. Most were in the prime family formation years. In addition, the petitioners were more likely to have stopped their formal education after high school and hold an unskilled position. The petitioners were much less likely to own their homes than the debtors and reported significantly less in terms of before-tax family income.

FOOTNOTES

[1] The option can be lawfully exercised only once within a six year period.

[2] See Durkin and Elliehausen (1978) for a complete description of the data from the survey. The data used here represent the subset of participants in the national survey who had outstanding instalment or revolving credit at the time of the survey.

[3] The change in the Consumer Price Index (CPI) was used to make the price level adjustments.

[4] One hundred and twenty-nine cases did not report an income figure. The average is based on those people who did report a reasonable income figure. Zero income was considered reasonable in some cases (See Monograph 23, Cahpter 3).

CHAPTER 2

THE ROUTE TO BANKRUPTCY

I. Overview

Given the cost of personal bankruptcy it may be desirable to reduce its incidence.[1] In order to do that, outside of decreasing the attractiveness of the bankruptcy option through legislation, one should have an understanding of how consumers get into financial distress. A major objective of this study was to analyze the alternate paths to bankruptcy taken by the households in our sample. In this chapter, we examine the petitioners' debt burden, the sources of consumer credit used, the petitioners' perceptions of the events that triggered their bankruptcy and the information sources used by the petitioners in their search for a solution to their financial problems.

II. Petitioners' Use of Nonmortgage Debt

In the market for business loans, the firm's ability to obtain additional credit and the terms of that credit are determined by bond rating systems or creditors' analysis of financial statements that in many cases have been audited and certified by independent third parties. In the market for consumer credit there are guidelines used by practitioners that suggest that a family's total monthly debt payments should be no more than a certain percentage of monthly income. An alternative rule says that a family that borrows from one source to repay another source within a month is using too much debt. However, consumers do not prepare audited financial statements. Consequently, creditors considering consumer loan applications, in most cases, may not have complete information about the true financial status of the applicants and cannot restrict the borrowers' subsequent use of credit from other creditors.[2] Thus, each individual household has the responsibility to discipline its own use of credit to that amount that is manageable, in light of the stability of family income, sources of emergency funds, attitudes toward risk and other factors.

A. Amount of Nonmortgage Debt

The average amount of nonmortgage, nonbusiness instalment credit in the portfolios of the petitioners was about $19,000. The distribution of nonmortgage debt outstanding for the petitioner sample is shown in Exhibit 2-1. Only 2.1 percent of the petitioners had less than $2,000 in nonmortgage debt outstanding at the time of the filing. Seventeen cases (less than two percent) had $500 or less in debts outstanding at the time of the filing. Eighty-three percent of the petitioner group had more than $5,000 in nonmortgage instalment debt outstanding.

The average (adjusted for changes in the cost of living) consumer debt outstanding for the debtor sample was about $3,000. Almost 20 percent had less than $500 in debt outstanding and only 36.2 percent owed more than $5,000 in consumer credit. Thus, it is clear that the petitioners' use of consumer credit differed sharply from that of the debtor sample.

The ratio of consumer credit outstanding relative to before-tax family income may be used as an indicator of the financial strength of a household.[3] The distributions of this ratio for the two samples are shown in Exhibit 2-2.

EXHIBIT 2-1

NONMORTGAGE INSTALMENT DEBT OUTSTANDING

(INCLUDING CREDIT CARD OUTSTANDINGS)

	1981 Bankruptcy Study	1977 Consumer Credit Survey*
$1-199	1.1%	11.0%
$200-499	.3	8.2
$500-999	.2	9.6
$1000-1999	.5	13.5
$2000 and more	97.9	57.8
$2000-2999	2.6	8.3
$3000-3999	5.6	6.6
$4000-4999	6.3	6.7
$5000 and more	83.4	36.2
	100.0%	100.0%

*Adjusted for price level change between 1977 and 1981.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study; 1977 Consumer Credit Survey, Board of Governors of the Federal Reserve System.

EXHIBIT 2-2

TOTAL INSTALMENT DEBT TO PRE-TAX ANNUAL FAMILY INCOME

Percent of Instalment Debt to Pre-tax Income	1981 Bankruptcy Study	1977 Consumer Credit Survey
1-25%	5.2%	61.7%
26-50%	12.6	16.5
51-75%	17.6	5.4
76-100%	10.9	2.8
More than 100%	44.9	13.6
Not ascertained	8.7	
	100.0%	100.0%

SOURCE: Credit Research Center, Purdue University. Consumer Bankruptcy Study, 1977 Consumer Credit Survey, Board of Governors of the Federal Reserve System.

Only 5.2 percent of the petitioners had a debt-to-income ratio of less than 25 percent. In contrast, 61.7 percent of the debtor sample had consumer debt which was less than or equal to 25 percent of their annual before-tax income. Almost 45 percent of the petitioner sample had consumer debts that exceeded 100 percent of annual income compared to only 13.6 percent of debtors.[4]

Using the debt-to-income ratio as a measure of credit risk, one can conclude that relative to debt users in general, the petitioners were generally poor credit risks at the time they filed for debtor relief. One explanation for the frequency of very high debt-to-income ratios, besides the possibility of loss of job, is that petitioners added large amounts of debt to holdings immediately before filing for bankruptcy. However, only 11 percent of the petitioner sample reported that credit was used for purchases of more than $200 in the six months before they filed for bankruptcy.

B. Types and Sources of Nonmortgage Credit

In the previous section we found that, on average, the petitioners owed about $19,000 in nonmortgage instalment debt at the time they filed for bankruptcy. In this section, we analyze the mix of secured versus unsecured credit in the consumer debt portfolios of the petitioners, the sources of unsecured credit and the collateral characteristics of the secured credit. Data used in this analysis were extracted from the bankruptcy petitions.

1. Unsecured Consumer Credit

On average, unsecured debts made up 63 percent of the total nonmortgage, nonbusiness debts in the petitioners' liability portfolios (Exhibit 2-3). Unsecured debt made up 80-100 percent of total consumer

EXHIBIT 2-3

UNSECURED DEBT AS PERCENT OF TOTAL DEBT*

(*NONMORTGAGE, NONBUSINESS DEBT)

Unsecured Debt as Percent of Total Consumer Debt	Percent
0-20 percent	7.0%
21-40 percent	12.0
41-60 percent	14.3
61-80 percent	19.3
81-100 percent	42.6
Missing values	4.8
	100.0%

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

debt outstanding for slightly more than 40 percent of the petitioners. Twenty percent of the petitions indicated that the petitioners had no secured debt at the time of the filing. Only seven percent of the petitioners primarily held secured debt (0-20 percent unsecured).

The source of credit and the outstanding balances for the unsecured debts reported on the petitions were analyzed. In Exhibit 2-4 we have summarized the percentage of respondents who had credit from each lender type, the average total amount of consumer credit owed to each type of lender, the average number of different loans from each type of lender, and the average dollar value of the obligations to each type of lender.

The petitioners were most likely to have unsecured credit from banks, retailers, medical sources, or others. The petitioners who had credit from banks had, on average, two bank relationships, one or both of which was likely to have been credit card accounts. The petitioners who had retail credit balances, on average, had accounts with about four different retailers. Sixty-one percent of the sample had credit from medical sources. Those who had outstanding balances owed about $400 of credit from each of 4.6 different medical sources. Finally, about 75 percent of the sample owed an average of $5,154 to other sources--nonmortgage lenders who did not fall into any of the other categories or whose name was such that it could not be identified as a member of one of the other lender categories by the person coding data from the petition.

Only 40 percent of the sample had unsecured loans from finance companies. The average total balance owed to finance companies was $2,694 with an average loan balance of $1,604. Twenty-three percent of the petitioners had one or more members of the household who belonged to a credit union. Seventeen percent of the petitioners had unsecured loans from a credit union with an average balance of about $1600.

The pertinent point to be drawn from Exhibit 2-4 is the frequency with which unsecured credit sources other than the financial instititons were used by consumer debtors filing for bankruptcy and the large dollar amounts of credit obtained from these sources. It is frequently the case that credit sources which are primarily sellers of goods and services do not report to credit bureaus especially when they have a small volume of credit sales. Consequently, the credit bureau report available to potential creditors may have revealed only the tip of the iceberg of credit being used by these consumers.

It is feasible that these consumers borrowed from nonconventional sources of credit (which are likely not to have sophisticated collection systems) to the extent possible in order to continue making payments on loans from banks, finance companies, credit unions, and major retailers. When their ability to draw on these sources was exhausted, bankruptcy court was the obvious solution. This scenario could explain the observation made by many conventional creditors that many of their accounts that went bankrupt had never shown a delinquency before the bankruptcy petition was filed.

In Exhibit 2-5, information provided in Exhibit 2-4 is shown with the sample categorized by total nonmortgage debt-to-family income ratios. The petitioners in the highest debt-to-income category were more likely to have a loan and had a greater number of loans from banks, finance companies and credit unions than those in the lowest debt-to-income category. In addition, the petitioners in the highest category had

EXHIBIT 2-4

SOURCES OF UNSECURED NONMORTGAGE INSTALMENT CREDIT

	Percent of Sample With Debt from:	Total Average Outstanding Balance from:	Average Number of Loans From Institutions of This Type:	Average Outstanding Balance Per Obligation:
Bank	58%	$4,186	2.1	$1,993
Credit union	17*	1,919	1.2	1,599
Finance company	40	2,694	1.7	1,604
Retailer	77	1,840	3.8	483
Dealer	24	4,914	4.6	1,073
Medical	61	1,829	4.6	400
Friend	13	5,367	2.0	2,738
Other, including not identified	75	5,154	4.1	1,260

*Represents 74 percent of petitioners who belonged to a credit union.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

EXHIBIT 2-5

TYPE AND NUMBER OF CREDITORS

(AVERAGE)

	Total Consumer Debt/ Pretax Family Income							
	<50%		50-74%		75-100%		>100%	
	% Had Debt*	Average #	% Had Debt	Average #	% Had Debt	Average #	% Had Debt	Average #
Banks	(51)	1.78	(50)	2.09	(63)	1.92	(64)	2.22
S & L	(2)	1.25	(2)	1.0	(3)	1.0	(5)	1.30
Credit unions	(11)	1.21	(20)	1.17	(25)	1.15	(17)	1.33
Finance companies	(36)	1.90	(38)	1.57	(45)	1.69	(42)	1.66
Retailers	(71)	2.93	(78)	3.15	(80)	3.32	(77)	4.58
Dealers	(15)	2.22	(19)	1.93	(24)	3.23	(29)	5.44
Medical	(59)	3.73	(62)	4.35	(58)	5.82	(64)	4.79
Friends	(4)	1.44	(8)	1.44	(13)	1.47	(19)	2.19
Other	(69)	2.87	(72)	3.21	(74)	3.19	(78)	4.97
N	213		211		130		540	
Average income	$11,461		$12,317		$12,594		$9,008	

*Percent who had debt from this particular type of creditor.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

obtained credit with greater frequency from retailers, dealers, medical sources and "others" than the petitioners in the lowest debt-to-income category.

The relationship between the ratio of unsecured debt relative to total consumer credit in each petitioner's portfolio and before-tax family income is shown in Exhibit 2-6. The distributions of the ratio of unsecured debt to total consumer debt were significantly different at the ten percent level across income groups. Fifty-one percent of petitioners in the lowest income category had unsecured credit that represented 80-100 percent of their total consumer credit outstanding compared to only 35 percent of those in the highest income category.

One could conclude that the consumer credit marketplace with its current information technology is unable to keep consumers from getting into financial distress. As consumers take on more debt relative to income they use more unsecured credit and increasingly depend on sources of unsecured credit that are less likely to check credit reports and, after granting credit, are less likely to report it to a credit bureau. In addition, such sources of credit are not likely to report delinquencies to a credit bureau. Not knowing the full extent of consumer's unsecured indebtedness, credit grantors cannot discipline the consumer in his or her use of unsecured credit unless consumers fully report outstanding debts on credit application forms.

2. Secured Credit

For each of the secured credit obligations listed on the petition, excluding mortgages, the type and market value of the collateral was

EXHIBIT 2-6

USE OF UNSECURED DEBTS BY INCOME GROUPS

Ratio of Unsecured Debt to Total Consumer Debt	Income Groups			
	Less Than $5,000	$5,000-9,999	$10,000-19,999	More Than $20,000
0-20 percent	4%	8%	8%	8%
21-40 percent	12	11	14	14
41-60 percent	12	15	17	17
61-80 percent	21	16	21	25
81-100 percent	51	50	41	35
	100%	100%	100%	100%

Total may not sum to 100 percent due to rounding.

$\chi^2 = 28.43$ Significant at ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

coded along with the outstanding balance at the time the petition was filed. The types, loan-to-market values ratios and average amounts of secured consumer credit are shown in Exhibit 2-7.

Half of the sample had at least one credit obligation secured by an automobile. (There were several cases where multiple automobiles and auto credit obligations were listed on the petition.) The petitioners' average outstanding balance per loan for auto credit was almost $3,700. More than half of the petitioners with auto credit indicated that the loan-to-value ratio was in excess of 100 percent. This is not surprising given the normally rapid depreciation of automobiles.

Forty-one percent of the sample had an average of 1.8 loans secured by household goods with an average balance on each of $850. Sixty-one percent of the petitioners had credit secured by household furnishings which had a loan-to-market value ratio greater than 100 percent. Under the federal exemptions most of this credit would be treated as unsecured if it was not purchase money credit.[5]

Few of the petitioners had credit secured by jewelry, or investment property. However, those loans secured by investment property had, on average, a $15,000 balance with the security valued at about $22,000. A small percentage of the petitioners reported having secured credit with an average balance of $3,696 that could not be classified in any other category.

In summary, the petition data indicate that the consumers who chose bankruptcy had amassed a huge amount of credit, with a heavy emphasis on unsecured credit obtained from retailers, medical sources and other nonclassifiable sources. Secured credit held by the petitioner was most

EXHIBIT 2-7

NONMORTGAGE SECURED DEBT

Security	Percent of Sample With Type of Debt	Average Dollar Amount Per Loan	Loan/Market Value	
Automobile	50%	$ 3,719	<100%	45%
			>100%	55%
Recreational vehicle	5	4,769	<100%	48%
			>100%	52%
Furniture/Appliances	41	859	<100%	39%
			>100%	61%
Jewelry/Furs	2	607	<100%	64%
			>100%	36%
Investment Property	2	15,297	<100%	78%
			>100%	22%
Other (nonclassified)	11	6,342	<100%	64%
			>100%	36%
Nonspecified	6	3,696	<100%	69%
			>100%	31%

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

frequently secured by personal vehicles and household furniture. For more than half of these credit obligations, however, creditors had considerable risk exposure in that the outstanding balance was greater than the market value stated on the petition.

The implications that can be drawn from this analysis relate to the efficiency of the market for consumer credit and the ability of the market to monitor the consumer's use of credit. Given the absence of complete information available to the creditor to evaluate the credit risk of a loan applicant, the responsibility of determining the amount of consumer debt that is managable, given the level and stability of income and other obligations, falls on the consumer. In the next section, we find that an inability to make this determination or abide by it was seen as an important cause of bankruptcy by many of the petitioners.

III. Petitioners' Perception of Causes of Bankruptcy

Studies of trends in bankruptcy using cross-sectional as well as time-series data have found evidence that the total number of personal bankruptcies filed each year nationally is associated with the rate of national unemployment, the ratio of annual consumer debt repayments to annual personal income (Yeager, 1978), and to the divorce rate (Heck, 1981). We sought further insight into the causes of personal bankruptcy by asking the petitioners to indicate which factors or events caused their financial distress and ultimate bankruptcy. Those events most frequently cited were medical bills, buying too much on credit and increases in the cost of living (Exhibit 2-8). Marital problems, loss

EXHIBIT 2-8

IMPORTANT FACTORS LEADING TO BANKRUPTCY

	Number	Percent
Personal Problems		
Medical bills (doctors, hospitals)	508	43%*
Marital problems (divorce, separation, alimony, child support)	333	28
Natural disasters (such as floods, hurricanes)	19	2
Death in the family	53	4
Addiction or dependency (Drugs, alcohol, gambling)	41	3
Employment Problems		
Cutback in the number of hours worked	200	17
Laid off or fired from work	318	27
Your business failed	175	15
Business that employed you failed	58	5
Unable to work due to illness/accident	246	21
Lost second income	189	16
Credit/Financial Problems		
Bought too much on credit	526	44*
Credit was too easy to get	334	28
Unable to get creditors to extend loans/ agree to different payment schedule	247	21
Creditors tried to collect their money	345	29*
Sued by creditors	279	23
Wages actually garnished	152	13
Some property repossessed	118	10
Cosigned on a loan that wasn't paid	71	6
Cost of living went up	542	45*
Other(s)	187	16

*Four most frequently mentioned causes.

Respondents could indicate multiple factors.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

of job and various actions taken by creditors to collect credit accounts were each cited by about one-fourth of the petitioners as a contributing cause of bankruptcy. When asked which one or two of the factors cited were the most important causes of bankruptcy (Exhibit 2-9) medical bills, using too much credit, marital problems and loss of job were most frequently indicated.

One would expect that the debt burden carried by a household would affect its susceptibility to unexpected changes in income attributable to loss of job, a breakup of a marriage, or a medical problem. It follows that the number of petitioners indicating a particular cause of bankruptcy may be different across petitioners grouped by their nonmortgage debt-to-family income ratios. The factors leading to bankruptcy cited by consumers in each of these debt-to-income (D/I) groups are shown in Exhibit 2-10. It is interesting to note that the three reasons cited most frequently by the first three groups (D/I <50%, 50-75%, 75-100%) were the same: medical bills, martial problems and excess use of credit. The group with instalment debt exceeding pretax income cited loss of job and own business failure more frequently than marital problems and excess use of credit. These data again provide some very interesting insight into the various paths of bankruptcy. Many of those in the highest debt-to-income category apparently arrived there by one of two routes: either they were overextended and lost a job or business, or they lost a job or had a business failure and subsequently became overextended in their use of credit (probably by drawing down lines of credit that had been approved before they lost their jobs). Those in the lower debt-to-

EXHIBIT 2-9

MOST IMPORTANT FACTORS LEADING TO BANKRUPTCY

	Number	Percent
Personal Problems		
Medical bills (doctors, hospitals)	183	15 *
Marital problems	148	12 *
Natural disasters	6	1
Death in the family	15	1
Addiction or dependency	10	1
Employment Problems		
Cutback in the number of hours worked	57	5
Laid off or fired from work	143	12 *
Your business failed	85	7
Business that employed you failed	22	2
Unable to work due to illness/accident	81	7
Lost second income	51	4
Credit/Financial Problems		
Bought too much on credit	166	14 *
Credit too easy to get	50	4
Unable to get creditors to extend/ agree to different payment schedule	47	4
Creditors tried to collect money	44	4
Sued by creditors	57	5
Wages actually garnished	47	4
Some property repossessed	8	1
Cosigned on a loan that wasn't paid	15	1
Cost of living went up	95	8
Other	100	8

*Four most frequently mentioned causes.

Respondents could indicate up to two factors.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

EXHIBIT 2-10

REASONS FOR BANKRUPTCY

(MOST IMPORTANT)

	Debt/Income			
	<50%	50-75%	75-100%	>100%
Number of cases	213	211	130	540
Personal Problems				
Medical bills (doctors,hospitals)	*16.9%	*15.6%	*19.2%	*15.0%
Marital problems	*12.2	*12.3	*17.7	11.5
Natural disasters	0	.5	0	.7
Death in family	1.4	.5	0	1.9
Addiction or dependency	.9	2.4	0	.5
Employment Problems				
Cutback of employment	7.5	4.7	3.8	4.4
Laid off, fired	11.3	9.0	13.8	*13.9
Business failure--own	1.9	2.8	2.3	11.7
Business failure--employer	.9	1.4	2.3	2.0
Disability	5.6	7.6	4.6	7.0
Loss of second income	2.3	3.8	5.4	5.2
Credit/Financial Problems				
Used excess credit	*11.7	*17.5	*16.2	*12.4
Credit obtained too easy	1.9	8.5	4.6	3.7
Creditors uncooperative	2.8	7.1	3.1	2.4
Creditors attempt collection	5.2	3.3	4.6	3.3
Creditors sued	7.5	1.4	5.4	5.2
Creditors garnished	6.6	4.7	4.6	2.4
Property repossessed	1.9	.5	0	.6
Cosigner	.9	.9	.8	1.1
Cost of living went up	9.4	8.1	6.2	8.5
Other	7.5	9.9	13.1	10.3

*Three most likely causes of bankruptcy

Respondent could indicate more than one reason

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

income categories had more manageable debt burdens but may not have perceived it as such. They apparently fell victim to an emotional or physical trauma and used the bankruptcy option as a way to reduce their stress.

A. Medical Bills

Almost two-thirds of the sample had medical bills outstanding at the time they filed for bankruptcy. Fifteen percent of the petitioners indicated that medical bills were one of the most important factors leading to their bankruptcy. Those petitioners who cited medical bills as the most important factor owed almost seven different medical sources of credit an average of about $550 each for an average total of almost $4,000 in unpaid medical expenses. In contrast, the petitioners in general owed an average of $400 to each of 4.6 medical credit sources for an average total of $1,840 in medical debts. Only 15 percent of the heads of household of those citing medical expenses as the cause of bankruptcy were unemployed at the time they filed for bankruptcy (compared to an overall unemployment rate of 20 percent). Apparently, the medical bills did not generally result from a condition that left the head of household permanently disabled.

B. Marital Problems

Twelve percent of the sample cited marital problems as one of the most important causes of bankruptcy. The life cycle data shown in Exhibit 1-1 suggest that the petitioners were generally young people (less than 45 years old) with small children. A divorce at this stage in the life cycle could place great financial burdens on the parties involved. As might be expected, of those respondents who cited marital difficulties as the most important cause of bankruptcy, one-third were divorced single parents. About 36 percent were separated, with children, at the time of filing. Twenty-eight percent were separated or divorced and had no dependents. The balance of the subgroup indicated that they were single at the time the petition was filed.

C. Excess Use of Credit

Fourteen percent of the sample indicated that one of the most important causes of bankruptcy was their excess use of credit although 44 percent of the sample cited this as a factor leading to their bankruptcy. However, this group did not have more nonmortgage instalment debt relative to income than the population of petitioners, although they obviously had more debt relative to income on average than the population of debt-users in general (Exhibit 2-2). This subgroup had less unsecured credit relative to total consumer credit than the petitioners. Only 34 percent of the "excess-credit" group had unsecured credit relative to total consumer credit of 80-100 percent while this was true for 43 percent of the petitioners. The sources of unsecured credit for this subset of the petitioners did not differ from those used by the population of petitioners. However, the average amounts owed to each source was several hundreds of dollars less. Sixty-two percent of the "excess-credit" group owed an average of $3,000 in unsecured loans to banks compared to $4,186 for petitioners in general. (See Exhibit 2-3 for comparable figures for total sample). Forty-six percent had loans from finance companies totalling an average of $2,500 compared to 40 percent of petitioners in general who owed $2,694 on average to finance companies. Almost 85 percent of the subgroup had credit from retailers totalling an average of $2,000 per petitioner. This compared to $1,840 owed to retailers, on average, by 77 percent of petitioners in general. The group was slightly less likely to use credit from dealers, medical sources, friends, or others than the petitioners in general. This subgroup was more likely, relative to petitioners in general, to have obtained credit from retailers, finance companies and banks although the differences were not large. The types and amounts of secured credit in the portfolios of this group did not differ significantly from that for the entire sample of petitioners.

D. Loss of Employment

Historically, the number of personal bankruptcy filings is highly correlated with the unemployment rate. However, only 12 percent of the sample indicated that loss of employment was one of the most important factors leading to their bankruptcy. Of this group 58 percent were unemployed at the time they filed their petition for debtor relief compared to an unemployment rate of about 20 percent for the sample in general.

E. Filing to Avoid Certain Creditors

Filing for bankruptcy to avoid paying certain creditors was given as a motivation for filing by almost 40 percent of the sample. Respondents most frequently wanted to avoid paying finance companies and banks (Exhibit 2-11). By comparing the percent of the sample that had unsecured credit from finance companies and banks, one gets a better idea of the importance of the desire to avoid creditors as a cause of bankruptcy.[6] For example, 58 percent of the petitioners had at least one unsecured

EXHIBIT 2-11

CREDITORS THAT PETITIONER DID NOT WANT TO REPAY

(PERCENT OF SAMPLE WHO INDICATED EACH TYPE)

Bank	10.2%
Savings and loan	2.8
Credit union	2.1
Finance company	13.5
Retailer/dealer/contractor	7.3
Friend/relative/coworker	.8
Doctor	4.7
Other	8.2

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

loan from a bank and ten percent of the sample wanted to avoid repaying a bank. Therefore, about 17 percent of petitioners with bank loans indicated that one of their motives for filing bankruptcy was to avoid repaying their bank loans. In contrast, almost one-third of the petitioners who had a loan from a finance company indicated that they wanted to avoid repaying that loan.

The petitioners were asked to indicate the actions taken by creditors before the bankruptcy petition was filed. The actions most frequently indicated were threatening letters and phone calls, threats of repossession and threats of garnishment. Those that were cited as most important in influencing the decision to file for bankruptcy were frequent telephone calls, threats of and actual garnishment, and threats of repossession. Six percent of the petitioners had had no creditor collection action taken against them. In contrast, three percent of the petitioners who indicated that they filed bankruptcy to avoid repaying particular creditors indicated that no collection action had been taken against them before they petitioned for bankruptcy.

IV. Record of Previous Bankruptcy

Currently the law specifies that a person may file for bankruptcy only once within a six year period. In addition, a record of a bankruptcy may be kept on the individual's credit report for ten years. Thus, a person who has a past bankruptcy may not find the credit markets accessible. However, one might expect that consumers who had mismanaged their personal finances to the point that they had to file for bankruptcy once might have a tendency to repeat that behavior unless they were unable

EXHIBIT 2-12

RECORD OF PREVIOUS BANKRUPTCY

	#	%
Respondent never filed before	313	26
Spouse never filed before	13	1
Neither respondent or spouse had filed before	770	64
Respondent filed individually before	50	4
Spouse filed individually before	33	3
Respondent filed jointly with current spouse	26	2
Respondent filed jointly with former spouse	21	2
Spouse filed jointly with former spouse	1	-
No response	2	-
Total	1229	

Multiple responses possible

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

to obtain credit after bankruptcy or the cost of bankruptcy was so high that it forced a modification of their credit-use practices. About nine percent of the sample of petitions involved at least one party who had filed for personal bankruptcy before (Exhibit 2-12). We analyzed the credit used by this group to determine if habitual financial mismanagement existed and to see if their portfolio of nonmortgage credit was obtained from sources that differed from those used by petitioners in general.

The most important causes of bankruptcy indicated by those petitioners who had filed before (Exhibit 2-13) were very similar to those for the total sample of petitioners (Exhibit 2-9). Medical bills, overuse of credit, and marital problems were indicated as the most important reasons by at least 13 percent of those who had declared bankruptcy at least once before. This group was less likely than the petitioners in general to indicate loss of job as one of the most important causes of bankruptcy (7.6 percent versus 12 percent). The fact that almost 15 percent of this subgroup (about the same percentage as the sample of petitioners in general) indicated overuse of credit suggests that the actual costs of bankruptcy under the old law were not great enough to discourage their future excess use of credit.

The distribution of the ratio of total nonmortgage debt to before-tax income for the petitioners who had filed for bankruptcy before was very similar to that for the petitioners in general. Almost 50 percent of the group which reported a prior bankruptcy had debt-to-income ratios of more than 100 percent compared to 45 percent of the petitioners in general. In addition, the distribution of the ratio of unsecured debt

EXHIBIT 2-13

MOST IMPORTANT CAUSE OF BANKRUPTCY

FOR THOSE WHO HAD FILED BANKRUPTCY BEFORE

N=105

Personal Problems	
Medical bills	*16.2%
Marital problems	*13.3
Natural disaster	0
Death in family	1.0
Addition or dependency	1.0
Employment Problems	
Cutback in hours worked	6.7
Laid off, fired	7.6
Respondent's business failed	9.5
Employer's business failed	1.9
Disabled due to illness/accident	6.7
Lost second income	5.7
Credit Problems	
Bought too much on credit	*15.2
Credit too easy to get	3.8
Unable to get loan extensions	1.9
Creditors tried to collect money	6.7
Sued by creditors	4.8
Wages actually garnished	1.0
Property repossessed	0
Cosigned on loan that wasn't paid	1.9
Cost of living went up	5.7
Others	8.6

*Three most frequently mentioned causes

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

to total nonmortgage debt was not significantly different from the distribution for the whole sample. Forty-one percent of the group reporting a prior bankruptcy had unsecured debt that made up 80-100 percent of total nonmortgage debt compared to 42.6 percent of the whole sample.

In Exhibit 2-14 the unsecured credit sources used by the petitioners who had filed for bankruptcy before are summarized. It is interesting to note that relative to the petitioners in general (Exhibit 2-3) the group that had filed for bankruptcy before were more likely to have credit from medical sources and friends. Members of the prior bankruptcy group were less likely to have credit from each of the other sources of credit than the sample in general. In addition, prior bankrupts who had credit from those sources had smaller loans, on average. These data suggest that, in general, after consumers file for bankruptcy, they may have difficulty getting credit from some sources. However, given the data, it is very difficult to conclude that a bankruptcy significantly limits one's future use of credit. Nor does it seem to change credit use practices. The data concerning the dates of the prior bankruptcies were not collected. However, if the previous bankruptcies had generally occurred more than seven years before, these data may not provide a valid indicator of the availability of credit immediately following a bankruptcy.

EXHIBIT 2-14

SOURCES OF UNSECURED NONMORTGAGE INSTALMENT CREDIT

(FOR THOSE WHO HAD FILED FOR BANKRUPTCY BEFORE)

Number of cases 105 petitions

Credit Sources:

Bank:	% with debt	50.4%
	Number of loans	2.1
	Average loan size	$1331
Credit Union:	% with debt	19%
	Number of loans	1.
	Average loan size	$1408
Finance Company:	% with debt	37%
	Number of loans	1.6
	Average loan size	$1261
Retailers:	% with debt	69.5%
	Number of loans	4.7
	Average loan size	$454
Dealers:	% with debt	21.9%
	Number of loans	4.4
	Average loan size	$999
Medical:	% with debt	76%
	Number of loan	4.8
	Average loan size	$461
Friends:	% with debt	20%
	Number of loans	2.1
	Average loan size	$2659
Others:	% with debt	75%
	Number of loans	5.3
	Average loan size	$1465

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

V. Petitioners' Information About Bankruptcy Procedures

A. Source of Information

The restrictions on the use of the bankruptcy option, the specifications of which assets will be liquidated and distributed among creditors, and the steps that must be completed before a person is declared bankrupt are not highly complex. However, the process and its costs and benefits may involve a great deal of uncertainty for most consumers. In addition, persons who went bankrupt in the past were usually ostracized. An interesting question, therefore, concerns the way in which a person who eventually files for bankruptcy finds out about the bankruptcy process. In addition, there has been considerable speculation concerning the importance of lawyer advertising of bankruptcy services as a source of information. To address these issues, the petitioners were asked to indicate where they got the idea to declare bankruptcy. Their responses are summarized in Exhibit 2-15.

The most frequently indicated sources of information were own general knowledge or friends, relatives, and coworkers. The indication is that people are talking about bankruptcy publicly. People are not inclined to talk openly and publicly about personal situations of which they are ashamed. The frequency with which public discussion was indicated as the source of the idea to declare bankruptcy could mean that there is not a great deal of shame involved with filing for bankruptcy today.

Twenty-one percent of respondents indicated that a lawyer or legal aid service was their source of information about bankruptcy and 16 percent indicated that they had seen or heard an advertisement that was

EXHIBIT 2-15

SOURCE OF IDEA TO DECLARE BANKRUPTCY

Source	#	%
Read article or book	97	8
Advertisement - newspaper/magazine	124	10
Advertisement - radio/television	67	6
Lawyer or legal aid service	252	21
Friend/relative/coworker	334	28
Credit counseling service	31	3
Employer	11	1
Own idea/general knowledge	364	30
Other	64	5
No response	1	--

Multiple responses possible

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

EXHIBIT 2-16

PETITIONERS' USE OF LEGAL ASSISTANCE

Hired a lawyer to file bankruptcy:	
No	4%
Yes	96%
How lawyer was selected:	
Family lawyer	20%
Referred by another lawyer	15
Advertisement	16
Recommended by friend, relative, coworker	27
Phone book	12
Other	8
No response	2
	100%
Legal fees paid:	
Less than $100	3.4%
$100 - 200	7.8
$201 - 300	19.0
$301 - 400	24.5
$401 - 500	17.0
$501 - 1,000	11.3
Greater than $1,000	1.0
Did not use lawyer	4.0
No response	12.0
	100.0%

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

their source of information about bankruptcy. Since an advertisement could have been one for legal services, lawyer advertising was probably a significant factor in the discovery process for many petitioners.

B. Use of Legal Assistance in Bankruptcy

Ninety-six percent of the petitioners filed for bankruptcy with the assistance of an attorney (Exhibit 2-16). Generally, the lawyer employed had been recommended by a friend, relative, or coworker or another lawyer. It follows that friends, relatives and coworkers must also be recommending a specific lawyer when they talk to others about the process of bankruptcy. The average fee paid for legal service was about $400. Fees paid to lawyers per petition ranged from $45 to $2,500.

C. Knowledge of Chapter 13 (Reorganization)

An alternative to filing straight bankruptcy (Chapter 7) is for the petitioner to seek court protection from creditors under Chapter 13. Under Chapter 13 the debtor's secured credit obligations are written down to the fair market value of the collateral when the market value is less than the outstanding balance. The court-appointed trustee approves a living expenses budget for the petitioner and the rest of the petitioner's after-tax income is allocated among the creditors, secured creditors usually being paid first. Thus, creditors will receive a proportion of the outstanding balance under a schedule set up and approved in the Chapter 13 proceedings. The expected amount received by creditors in a Chapter 13 case cannot be less than what they would have recovered if the petitioner had taken straight bankruptcy. If the petitioner does not pay the trustee according to the schedule, the trustee may garnish the petitioner's wages, or ask the judge to dismiss the Chapter 13 schedule, in which case the creditors may once again initiate collection action.

Both a Chapter 7 and a Chapter 13 may be recorded on the petitioners' credit report for ten years after the court action. There is no time limit with regard to the frequency with which a petitioner can file Chapter 13 although the maximum payout period is usually three years. The petitioner would probably expect ultimately to repay more of his total outstanding debt under Chapter 13 than Chapter 7. However, by choosing Chapter 7, some debts that would be dismissed under Chapter 13 are not dismissed. Thus, it is difficult to make a general statement about the benefits net of costs of the two debt relief plans.

A consumer who is seeking debtor relief may choose Chapter 7 or Chapter 13. The choice should be a function of the relative costs and benefits of the two plans. However, in some court districts the choice may be influenced by the bankruptcy judge. The debtor's lawyer may direct the consumer to either Chapter 7 or Chapter 13 on the basis of what is known about the judge's past decisions. For the second quarter of 1981, 77 percent of total personal bankruptcies (Chapter 7 and Chapter 13) granted in the 20 bankruptcy court districts included in the study were Chapter 7 bankruptcies. The minimum was 60 percent in the district in Northern Illinois and the maximum was 92 percent in the Western Pennsylvania district.

The petitioners' knowledge of Chapter 13 was examined in this study. Sixty percent of respondents knew that there was an alternative legal process to the one they had used (See Exhibit 2-17). Of that group, two-thirds knew that the process was called Chapter 13. Those respondents most frequently indicated that the reason they did not seek relief from their debts under Chapter 13 was that their income was not high enough or their debts were too high. Twenty-one percent of those who knew about Chapter 13 had been advised against using that alternative by their attorney. We were not able to determine whether this advice reflected the lawyer's knowledge of the judge in the district or if the lawyer was trying to help the petitioner minimize the cost of bankruptcy.

D. Knowledge of Ability to File for Bankruptcy in the Future

After filing for bankruptcy, a consumer is legally restricted from filing again within six years. Almost three-fourths of the sample knew that they could file again and the bulk of those who knew were also aware that they could file again in the seventh year (Exhibit 2-18). Of those who knew they could file for bankruptcy again, 85 percent indicated that they would not or did not expect to have to use that option again. Thus, one could conclude that the majority of petitioners did not believe *a priori* that the gains from filing for bankruptcy were great enough to entice them into bankruptcy as frequently as was legally possible. Of those who said they would consider filing for bankruptcy again, 15 percent had already filed for personal bankruptcy at least twice (this time and at least one time previously).

EXHIBIT 2-17

KNOWLEDGE OF CHAPTER 13 PROCEDURES

Heard of alternative legal process:

Yes	60%
No	40
	100%

Of those who had heard of alternative response:

What was process called?

Chapter 13	68%
Other	8
Don't know	24
	100%

Why was Chapter 13 not used?

Attorney advised against it	21%
Spouse/friends advised against it	0
Not enough income/debts too high	47
To avoid paying particular creditors	2
No particular reason	6
Other	27

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

EXHIBIT 2-18

KNOWLEDGE OF ABILITY TO FILE FOR BANKRUPTCY AGAIN

Cannot file again		6%
Don't know/No response		21
Can file again		73
Within:		
6 years or less	17%	
7 years	45	
8 years and over	5	
Don't know/No response	6	
		100%

Among those who knew they could file again, would they?	
Yes	15%
No	45
Don't expect anymore problems	14
Don't intend to let this happen again	25
No response	1
	100%

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

E. Knowledge of the Effect of a Bankruptcy on the Credit Report

When a consumer's debts are discharged in bankruptcy courts, a record of that event is made in their credit report and can remain there for ten years. This record would contribute to the costs of bankruptcy if creditors interpret that information as an indicator of high credit risk and refuse to extend credit to persons who have a bankruptcy in their past.

The extent to which respondents were aware of the effect of bankruptcy on their credit report was measured by asking each respondent directly whether his or her bankruptcy would be recorded on their credit report. Ninety-two percent of respondents knew that the bankruptcy would be recorded (Exhibit 2-19). Forty-five percent thought that the bankruptcy would remain on their credit record for seven years. By law, the record can be kept for ten years. Only six percent of the petitioners knew the record could be kept for ten years. One-fifth of respondents did not know how long the record of the bankruptcy would appear on their credit report.

VI. Alternatives to Bankruptcy

When a consumer gets into financial difficulty there are several alternative actions that can be taken to bring the financial condition of the household under control. Given the long-term effects of a bankruptcy, one would expect that a petition for bankruptcy would be made only after unsuccessful attempts at alternative remedial actions had been made. The alternatives considered in this study were credit counseling, debt consolidation loans, selling assets, or rearranging loan payment schedules.

EXHIBIT 2-19

KNOWLEDGE OF IMPACT OF BANKRUPTCY ON CREDIT REPORT

(PERCENT OF RESPONDENTS)

Knowledge that bankruptcy was recorded on credit report:

No	8%
Yes	92
	100%

How long will the bankruptcy be recorded on the credit report:

Six years or less	13%
Seven years	45
Eight years or over	12
Do not know/no response	21
	92%

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

Most of the petitioners had heard of the four alternatives to bankruptcy that were examined. Petitioners were most likely to have heard of debt consolidation loans or rearranging payment schedules (Exhibit 2-20). The petitioners were least likely to have heard about credit counseling.

We analyzed the petitioners' use of alternatives to bankruptcy and the reasons given by those who did not try these various alternatives prior to bankruptcy. The petitioners were most likely to have tried rearranging their debt payment schedules and least likely to have tried credit counseling. Those who had heard of the various alternatives to bankruptcy but had not tried them and gave a reason for not trying were most likely to say they had no assets or income and too much debt and therefore did not try. Eight percent of the total sample did not try any of the above mentioned alternatives before filing for bankruptcy.

We can glean several very interesting conclusions from these data. The first is that a third of the total sample of petitioners had obtained a debt consolidation loan before actually going bankrupt. With the change in the bankruptcy law and the huge surge in losses for unsecured creditors that followed, many of the providers of debt consolidation loans have ceased to make unsecured debt consolidation loans.[7] Thus, the Bankruptcy Reform Act of 1978 reduced the availability of an alternative that may be successfully used to avoid bankruptcy by many consumers. If so, it may have contributed to the continued high level of personal bankruptcies after the Bankruptcy Act went into effect.

EXHIBIT 2-20

ALTERNATIVES TO BANKRUPTCY

	Heard About:	Heard About and Tried:
Credit counseling	59%	20%
Debt consolidation loans	82	34
Selling assets	75	21
Arranging different payment schedules	81	54

Why alternatives were not tried:

	Credit Counseling	Debt Consolidation	Selling Assets	Rearranging Payments
Heard about but did not try:	38%	47%	53%	25%
Reasons for not trying alternatives:				
No assets	--	--	41	--
Wanted to preserve assets	--	--	4	--
No income	8	10	--	6
Non-cooperative creditors	--	1	--	3
Over extended on credit	10	11	1	5
Did not think of it	2	1	--	1
No reason	11	8	2	5
No response	7	16	4	5
	38%	47%	53%	26%

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

The second conclusion concerns credit counseling. Only one-fifth of the sample had heard of and tried credit counseling. Half of those who were aware of credit counseling but did not try it thought their debt was too high or income too low for credit counseling to help. The rest gave no reason for not trying credit counseling. These responses indicate that few of those who really need credit counseling are aware of it and have enough confidence in the idea to try it before going to bankruptcy court. Undoubtedly, more resources must be employed in credit counseling to make that an effective alternative to bankruptcy.

VII. Summary

The path to bankruptcy as revealed by analysis of this sample of petitioners was paved by an inordinately heavy use of consumer credit relative to family income. Petitioners had credit from a multitude of sources but were frequent users of unsecured credit from medical sources, dealers, retailers, friends and others. Those who had consumer instalment debt which totaled more than 100 percent of family income were heavy users of those sources of credit.

The petitioners most frequently indicated that one of the factors which was the most important cause of bankruptcy was a medical problem, a marital problem, loss of job, or excess use of credit. Each of these factors were mentioned with about the same frequency. Forty percent of petitioners said that one of the reasons they filed bankruptcy was a desire to avoid paying a particular creditor--most frequently a finance company or a bank.

About nine percent of the petitioners had filed for bankruptcy before. The causes of bankruptcy for this subgroup were about the same as for the sample in general except that this group was less likely to cite loss of employment. Their sources of credit as reported on their second bankruptcy petition were approximately the same as those for the sample in general. The repeat petitioner was slightly more likely than the sample in general to use credit from medical sources and friends.

Petitioners were most likely to get information about bankruptcy from their family, friends and coworkers. Many got the idea to file for bankruptcy from an advertisement and 96 percent of the sample employed a lawyer at an average fee of $400. Most petitioners knew about Chapter 13 but did not use it either because they did not have enough income to pay back any debts or because their lawyer advised against it.

Most petitioners knew they could file for bankruptcy again but only 15 percent said they would consider such action. Most also knew the bankruptcy would appear on their credit record. Only six percent knew that the bankruptcy would remain on their credit report for ten years.

The petitioners had heard of alternatives to bankruptcy and only eight percent filed for bankruptcy without attempting credit counseling, debt consolidation loans, selling assets or negotiating different terms with creditors. Relatively few had heard about and tried credit counseling. Most knew about it but did not try credit counseling and expressed doubt that they had enough income to repay their debts.

FOOTNOTES

[1] See Monograph 23, Credit Research Center, Purdue University; Chapter 4 for an estimate of the cost of bankruptcy borne either by producers or creditworthy consumers who do not default or who, as a result of high perceived credit risk, are denied credit.

[2] Credit bureau reports do not purport to represent the universe but only a sample of the debtor's relationships and payment habits.

[3] The ratio of monthly debt payments to monthly income is a more meaningful measure of consumer indebtedness. However, data on size of monthly payments on outstanding credit for each petitioner were not available.

[4] More than 60 percent of those who seek financial counseling at offices of the Consumer Credit Counseling Service around the nation are married and owe more than 50 percent of their annual salary. Peter Costa, "Feel Buried by a Mountain of Debt?", Indianapolis Star, March 7, 1982, p. 1, section 5.

[5] See Monograph 23, Credit Research Center, Purdue University; Chapter 4 for the statement of the provision in The Bankruptcy Reform Act of 1978 governing such collateralized loans.

[6] We assumed the petitioner filed to avoid paying an unsecured creditor. If a consumer simply decides that he or she does not want to repay a secured creditor, the collateral will be repossessed and a deficiency judgment may be entered. If the consumer takes bankruptcy to avoid paying a secured debt, the collateral will be repossessed and the deficiency becomes an unsecured claim. The consumer would simply default on the loan if the expected cost of the deficiency judgment in a simple default is less than the expected cost of bankruptcy. Given the costs of bankruptcy, it seems logical that the consumer would choose default over bankruptcy to avoid paying a secured loan.

[7] "Weak Loan Business Hits Beneficial Hard, and Some Say a Takeover Is Its Best Hope," The Wall Street Journal, February, 1982.

CHAPTER 3

THE COSTS OF BANKRUPTCY

I. Overview

The costs of resolving one's immediate financial problems by taking bankruptcy (Chapter 7) are a function of the value of assets forfeited relative to the amount of debt that is discharged and the cost of the petitioner's subsequent reduced ability to obtain credit. The first cost with regard to the value of assets forfeited is determined by state or federal laws governing bankruptcy. Those laws specify how the assets owned by the petitioner will be distributed among the various creditors listed on the bankruptcy petition. Unlike a business bankruptcy, the law with regard to personal bankruptcy specifies that the petitioner is entitled to keep a set of exempt assets with which to make a "fresh start" after bankruptcy. Nonexempt assets are available to satisfy the claims of unsecured creditors.

The value of personal and household goods which is exempt from the claims of creditors in a state is determined by The Bankruptcy Reform Act of 1978 unless that specification was overridden by individual states after the effective date of the Act in 1979. In those states that have not overridden the federal specification of exemptions, the petitioner may choose that definition of exemptions (state or federal) that is the most beneficial given the type and value of assets owned by the petitioner. As a result of this characteristic of the current personal bankruptcy legislation, it is likely that the "cost" of personal bankruptcy measured by the change in net worth (total assets minus total liabilities) before and after bankruptcy would be positive for most consumers, especially for those who were making optimal use of their option to take bankruptcy. In other words, the net worth or wealth of a petitioner will be greater after bankruptcy than it was before bankruptcy.

To understand the optimal use of the bankruptcy option (assuming the petitioner's motive is to maximize personal wealth) one should view the act of petitioning for bankruptcy as exercising an option contract. That contract allows the petitioner to buy back his or her unsecured debt obligations and reduce secured debt obligations to the market value of the underlying collateral, at an exercise price equal to the market value of nonexempt available assets. Available assets are defined as total assets less assets that serve collateral for secured credit. Other things being equal, the lower the exercise price, the higher is the gain from bankruptcy. Thus, one would not expect petitioners to file for bankruptcy when total available assets were significantly less than the exempted assets allowed in view of the fact that once used, the bankruptcy option cannot be used again within six years. Additionally, the more total available assets exceed the allowed exemptions the greater is the price of the bankruptcy option. Thus, the optimal time to exercise the bankruptcy option is when the market value of available assets is approximately equal to the allowed asset exemptions and the consumer has amassed as much unsecured credit as possible.

In this chapter, we tabulate the petitioners' expectations of asset losses from bankruptcy and calculate a measure of the effect of bankruptcy on the net worth of the petitioners. The distribution of the percentage change in net worth is analyzed relative to the economic characteristics of the petitioners, their exposure to asset losses, the composition of debt portfolios, the level of state exemption laws in the states where the data were collected, and their ability to repay debts out of income. Finally, we examined the petitioners' evaluations of their ability to obtain credit after bankruptcy from various credit sources.

II. Expected Loss of Assets

When an individual files for bankruptcy, purchase money secured debts may be partially satisfied by repossession of the collateral. In order to keep the collateral, the petitioner must reaffirm the debt. In the event of reaffirmation, the outstanding balance of the secured loan is adjusted to the market value of the collateral if the market value is less than the outstanding balance. Otherwise, the debt is reaffirmed for the amount of the outstanding balance. Unsecured debts, including deficiencies that arise when the market value of the collateral on a reaffirmed secured loan is less than the outstanding balance, are paid out of proceeds from the liquidation of the pool of nonexempt available assets owned by the petitioner. Sixty-three percent of petitioners in our sample indicated that they did not expect to lose any assets as a result of filing for bankruptcy.

An analysis of total assets claimed exempt by the petitioner relative to total assets (excluding assets which have secured claims against them) declared on the petition indicated that there was considerable variation in the asset retention rate in the sample of

EXHIBIT 3-1

EXEMPT ASSETS AS PERCENT OF TOTAL AVAILABLE ASSETS

(NONBUSINESS BANKRUPTCIES)

	Absolute Frequency	Relative Frequency	Adjusted Frequency
0[1]	364	32.0%	--
Less than 25 percent	48	4.2	6.2%
25-50 percent	201	17.6	25.9
51-75 percent	241	21.2	31.1
76-99 percent	120	10.5	15.5
100 percent or more[2]	165	14.5	21.3
	1139	100.0%	100.0%

[1] Cases where values for total assets, exempted assets, or secured debts were not provided on the petition.

[2] Exempted assets were greater than total available assets when petitioners claimed the maximum exemption in assets regardless of the fact that their equity was less than the allowed exemption.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

petitioners (Exhibit 3-1). The asset retention rate is revealed by the ratio of total market value of exempted assets listed on the petition (Schedule B-4) relative to the total market value of assets that were not serving as security on a loan. The denominator of the ratio is the total asset figure from the petition minus the lesser of the outstanding balance or the market value of security for each secured claim listed in Schedule A-2 (secured claims). About 68 percent of those providing enough information to make the necessary calculations had more than 50 percent of available assets exempted from the claims of unsecured creditors. About 21 percent reported exempt assets which were equal to or greater than 100 percent of available assets. About 32 percent of the sample who provided the information were heavily exposed to loss of assets. This finding is consistent with the questionnaire data where about 40 percent of the petitioners indicated that they expected to lose some assets as a result of bankruptcy.

An analysis of assets owned by the petitioners and their assessments of what they would lose, what was exempted and what was going to be kept through reaffirmation provides some insight into the specifics of asset redistribution in bankruptcy (Exhibit 3-2). The assets most likely to be owned by the petitioners were a car, furniture, and clothing. In more than 90 percent of the cases, those who owned one or more of those goods expected them to be exempt in the bankruptcy procedure. Petitioners planned to keep some assets (primarily a house, truck, car, or land) by reaffirmation. Few indicated that they expected to lose specific assets listed in Exhibit 3-2.

EXHIBIT 3-2

EXPECTED COST OF BANKRUPTCY: EFFECT ON ASSET OWNERSHIP

		Of Those Who Owned:		
	Percent of Sample who Owned:	Keep Through Exemption	Reaffirmation	Lost
Financial assets	14.2%	85%	--	15%
House	24%	94%	67%	6%
Car	60%	91%	47%	9%
Truck	12%	93%	53%	0
Recreation vehicle	4%	88%	40%	1%
Furniture or appliances	72%	96%	22%	8%
Jewelry/furs	27%	99%	10%	0
Clothing	76%	100%	6%	0
Land/investment property	4%	83%	45%	.5%

NOTE: Percents do not add to 100 percent for each type of asset because petitioners could have multiple assets in each category or because equity in asset was exempted but asset served as collateral for a purchase money loan and the loan was also reaffirmed.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

The asset retention ratio of a petitioner is determined by the level of allowed exemptions in the state where the petition is filed. In Exhibit 3-3 the distribution of the ratio of exempted assets to available assets in the low and high exemption states is shown. The petitioners in the high exemption states were significantly more likely to have exemptions which protected 50 percent or more of their total available assets than petitioners in the low exemption states. Thus, the petitioners in the high exemption states enjoyed a lower average cost of bankruptcy than petitioners in the low exemption states.

In summary, the expected loss of assets does not appear to represent a prohibitive cost for most petitioners who had made the decision to file for bankruptcy. Most did not expect to lose assets which were obtained via a purchase money loan because they planned to reaffirm the secured debts. Additionally, more than half of available assets were covered by exemptions for about 68 percent of the petitioners. However, only about 21 percent of the sample claimed exemptions which protected the total of their available assets. The decision to take bankruptcy would be rational for those with nonexempt assets only if the expected amount of unsecured claims discharged in bankruptcy exceeded the expected amount of assets forfeited.

III. Estimated Change in Wealth From Bankruptcy

The balance sheet information provided on the bankruptcy petition permits an estimate of the net worth or wealth position of each petitioner, both before and after bankruptcy. The difference between the two is the increment in the petitioner's wealth attributable to bankruptcy.

EXHIBIT 3-3

ASSET EXPOSURE BY EXEMPTION LEVELS

(NONBUSINESS BANKRUPTCY)

Ratio Of Exempt Assets To Available Assets	Low Exemption States	High Exemption States
Less than 25 percent	8.8%	3.9%
26-50 percent	28.1	24.0
51-75 percent	28.9	33.0
76-100 percent	26.2	24.8
Greater than 100 percent	8.0	14.3
	100.0%	100.0%

χ^2 = 17.33 Significant at ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

Net worth before bankruptcy is equal to the difference between the market value of total assets and the face value of total liabilities (secured plus unsecured debts plus claims with priority). After bankruptcy, the petitioner's assets are equal to the total of assets retained through exemption and reaffirmation of secured claims plus any residual assets remaining after the claims of unsecured creditors are satisfied. Total liabilities are equal to the value of secured claims which were reaffirmed plus claims of creditors with priority. The secured debts total was the sum of the outstanding balance or market value of the collateral for each of the secured debts listed in the Schedule A-2 section of the petition.[2]

For the calculation of the effect of bankruptcy on the petitioners' wealth it was assumed that all secured debts were reaffirmed, even though the petitioner might not have had any equity in the asset. This assumption had no effect on the size of the dollar change in net worth calculation. For example, assume a petitioner listed only one asset, an automobile with market value equal to $3,000. The only liability listed was the loan for the vehicle with outstanding balance equal to $5,000. If the car was repossessed and the deficiency judgment were discharged in bankruptcy court,the petitioner would realize a $2,000 increase in net worth by filing for bankruptcy: net worth before: -$2,000; net worth after: $0. If the loan were reaffirmed, the loan balance would be reduced to the market value of the car. Again, the petitioner would realize an increase in net worth of $2,000: net worth before: -$2,000; net worth after: $0.

All of the information needed to calculate the change in net worth realized from filing a nonbusiness personal bankruptcy was available for only 860 petitioners or about 72 percent of the sample. An analysis of the income distribution for those petitioners who provided complete data versus the rest of the sample showed that the hypothesis that the two groups were not drawn from the same population was rejected at the ten percent level of confidence.[3] Thus, the conclusions drawn from the analysis of the small sample will be generalized to the population of nonbusiness petitioners.

The distribution of dollar value changes in net worth attributable to bankruptcy is shown in Exhibit 3-4. Thirteen percent of the sample actually realized a zero gain from bankruptcy before transactions costs. Slightly more than 40 percent of the petitioners realized less than a $5,000 increase in net worth. About 11 percent realized a gain in net worth of more than $20,000. Relative to the average before-tax family income of $10,400 reported by the respondents the gain realized by the average petitioner in bankruptcy represented a significant "windfall."

Those petitioners who were filing for bankruptcy but were going to realize a zero change in net worth before transactions costs appear to have made an irrational decision. These petitioners had assets that exceeded their exemptions by a considerable amount. In addition, they had total unsecured debts that were less than their nonexempt asset total. The effect of bankruptcy on their wealth position was that they lost assets equal to the write-down in value of unsecured debts. Consequently, the after bankruptcy net worth for this group was equal to the before bankruptcy level of net worth, before transactions costs. However, transactions costs are positive and other costs such as loss of access to credit markets may be material. Their action therefore suggests that perhaps they filed because the did not anticipate actually losing nonexempt assets. If unsecured creditors do not exercise their rights or are not allowed to, all nonexempt assets may not be liquidated in bankruptcy.

In Exhibit 3-5 we show the distribution of the dollar value of change in net worth from bankruptcy in our sample relative to the before-bankruptcy net worth position of the petitioners. The interesting point shown by this table is that most of those petitioners who had a large amount of net worth before bankruptcy gained nothing from bankruptcy. Those who filed with a negative net worth--71.8 percent of the sample reported liabilities exceeding assets--were most likely to realize the largest gains from bankruptcy.

The distribution of the percentage change in net worth realized by the sample indicated that the bulk of petitioners (53.6 percent) had a percentage change in household wealth of 101-200 percent (Exhibit 3-6). About 16 percent of the petitioners realized a gain in net worth in excess of 200 percent. These statistics indicate that most petitioners for personal bankruptcy realized large increases in wealth. In the next section, we analyzed these gains from bankruptcy relative to the asset retention ratio, before-tax family income, mix of secured versus unsecured consumer credit in the petitioner's portfolio, and state exemption levels.

EXHIBIT 3-4

DOLLAR VALUE OF GAIN FROM BANKRUPTCY

(CHANGE IN NET WORTH)

N = 860

	Number	Percent
Less than zero	2	.2
Zero	113	13.1
$0 - 2,500	92	10.7
$2,5001 - 5,000	159	18.5
$5,001 - 7,500	145	16.9
$7,501 - 10,000	110	12.8
$10,001 - 15,000	121	14.1
$15,001 - 20,000	26	3.0
Greater than $20,000	92	10.7
	860	100.0

SOURCE: Credit Research Center, Purdue University, Consumer BAnkruptcy Study.

EXHIBIT 3-5

PERCENT DISTRIBUTION OF CHANGE IN NET WORTH FOR GIVEN LEVEL OF NET WORTH BEFORE BANKRUPTCY

	Net Worth Before Bankruptcy				
Absolute Change in New Worth	Less than $-5,000	$-5,000 to 0	$1 to 5,000	$5,001 to 15,000	Greater than $$15,000
Zero	0 %	.2%	12.4%	50.0%	80.0%
$1 - 2,500	.3	12.1	48.3	17.6	7.1
$2,500-5,000	.8	52.4	19.1	11.8	1.2
$5,001-7,500	17.8	24.6	7.9	11.8	3.5
$7,501-10,000	22.2	7.7	4.5	4.4	2.4
$10,001-20,000	35.1	2.4	6.7	2.9	3.5
>$20,000	23.8	0	1.1	1.5	2.4
	100.0%	100.0%	100.0%	100.C%	100.0%

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

A. Factors Related to Changes in Wealth

1. Asset Retention Ratio

One would expect to find that those petitioners who had fewer exposed assets (equity in assets which was not exempt from the claims of unsecured creditors) would realize the greatest relative wealth benefits of bankruptcy. This would be due to the fact that in the circumstance where most assets were exempt, the assets of the petitioner would remain largely intact while liabilities would be reduced or totally discharged. The relationship between the distributions of the ratio of exempt assets to total available assets and the percentage change in net worth is shown in Exhibit 3-7.

Those petitioners who had more than 100 percent of available assets protected by exemptions were most likely to have realized a gain in net worth of more than 100 percent. Those petitioners who had unprotected assets were more likely to earn a lower percentage change in net worth. However, some petitioners realized very large percentage gains in net worth, irregardless of exemption coverage of available assets. This result is attributed to the very high level of unsecured debts relative to nonexempt assets for some members of the sample.

2. State exemption levels

The distributions of the asset retention ratios were significantly different in the low and high exemption states. Given the significance of the relationship between the measure of asset exposure and wealth gains from bankruptcy, we expected to find the distribution of wealth gains to be significantly different in the two treatment areas. The distributions of these two variables are shown in Exhibit 3-8. The

EXHIBIT 3-6

PERCENTAGE CHANGE IN NET WORTH

N = 860

	Number	Percent
Zero	115	13.4
Less than 25 percent	34	4.0
25-50 percent	25	2.9
51-75 percent	21	2.4
76-100 percent	71	8.3
101-200 percent	461	53.6
Greater than 200 percent	133	15.5
	860	100.0%

SOURCE; Credit Research Center, Purdue University, Consumer Bankruptcy Study.

EXHIBIT 3-7

GAIN FROM BANKRUPTCY

N = 775

	Exempted Assets Relative to Available Assets		
Percentage Change In Net Worth	Less than 50%	50-100%	Greater Than 100 Percent
Less than 100 percent	26.2%	25.9%	3.3%
101-200 percent	61.8	53.9	80.7
Greater than 200 percent	12.0	20.3	15.9
	100.0%	100.0%	100.0%

χ^2 = 54.37 Significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

distributions of changes in net worth are significantly different in the high versus low exemption states. However, the petitioners in the high exemption states were not significantly more likely to realize gains in excess of 200 percent than petitioners in the low exemption states.[4] The petitioners in the high exemption states were significantly more likely to realize a gain in net worth of less than 25 percent than petitioners in the low exemption states.[5]

3. Before-tax family income

An analysis of the distribution of before-tax family income relative to the wealth gains from bankruptcy showed that the distributions of wealth gains across income categories were not significantly different at the ten percent level of confidence.(Exhibit 3-9). In contrast to the low income categories, more petitioners in the highest income category gained less than 100 percent in terms of wealth. This is attributable to the fact that high-income petitioners had more assets and were more likely to have available assets which were not adequately protected by exemptions. In addition, high income petitioners used less unsecured credit than low income consumers. Thus, their gains from bankruptcy from reduced liabilities were limited and were offset to a large extent by a loss of assets. In contrast, low-income petitioners with few assets were more adequately protected from asset losses by the exemptions. Thus, their assets stayed the same and liabilities were reduced to the value of secured liabilities. The same percent of high income petitioners earned gains in excess of 200 percent of net worth as the petitioners in the lowest income categories.

EXHIBIT 3-8

GAINS FROM BANKRUPTCY BY EXEMPTION LEVELS

Percentage Change In Net Worth	Low Exemption State	High Exemption State
Less than 25 percent	14.4	19.7
25-50 percent	3.3	2.5
51-75 percent	1.7	3.2
76-100 percent	11.3	5.3
101-200 percent	55.3	51.9
Greater than 200 percent	13.9	17.4
	100.0%	100.0%

χ^2 = 16.78 Significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

An analysis of the wealth gains from bankruptcy relative to the mix of the petitioners' debt portfolios between secured and unsecured consumer debt adds support to the scenario provided above. Those petitioners whose debt portfolios were primarily unsecured debt were significantly more likely to realize gains in wealth in excess of 100 percent than those petitioners who primarily had secured credit in their portfolios (Exhibit 3-10). Those petitioners with little unsecured debt were most likely to realize an increase in net worth less than 100 percent.

4. Ability to repay debts

Finally, a formal analysis of the gains from bankrutpcy relative to the ability of petitioners to repay their debts out of income (as defined in Monograph 23, Chapter 3) showed that those petitioners who were judged as being able to repay 25 percent or less of their debts out of available income in 36 months were more likely to experience gains in wealth of 100-200 percent than those petitioners who could have repaid more than 75 percent of debts out of income over 36 months (Exhibit 3-11). However, those petitioners who could have repaid 25 percent or less of their debts within 36 months were not significantly more likely to have realized a gain in net worth of 200 percent or more than those who could have repaid more than 25 percent of their nonmortgage debts. Twenty-four percent of those petitioners who could have repaid most of their debts in 36 months gained less than 25 percent of their net wealth position before bankruptcy by taking bankruptcy.

In summary, our data show that significant gains in wealth are earned by most consumers who file bankruptcy. The bulk of petitioners realized more than a 100 percent gain in net worth. Almost 16 percent realized

EXHIBIT 3-9

GAINS FROM BANKRUPTCY BY INCOME

N = 860

	Before-Tax Family Income				
Percentage Change In Net Worth	Less Than $5,000	$5,000-$10,000	$10,001-$15,000	$15,001-$20,000	Greater Than $20,000
Less than 100 percent	26.9%	29.4%	28.1%	37.3%	38.3%
101-200 percent	57.5	56.1	55.3	45.3	46.1
Greater than 200 percent	15.6	14.5	16.6	17.4	15.6
	100.0%	100.0%	100.0%	100.0%	100.0%

$\chi^2 = 9.66$ Insignificant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

EXHIBIT 3-10

GAINS FROM BANKRUPTCY BY DEBT PORTFOLIO CHARACTERISTICS

N = 833

Percentage Change In Net Worth	Percent Of Consumer Debt That Was Unsecured				
	0-20%	21-40%	41-60%	61-80%	81-100%
Less than 100 percent	46.0%	41.8%	39.5%	35.8%	21.2%
101-200 percent	40.0	41.9	49.6	44.7	62.8
Greater than 200 percent	14.0	16.3	10.9	19.5	16.0
	100.0%	100.0%	100.0%	100.0%	100.0%

$\chi^2 = 63.36$ Significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

a gain in net worth of more than 200 percent. Gains in excess of 100 percent were most likely to accrue to those petitioners who had assets exemptions which were more than 100 percent of available assets. Petitioners in the lowest income categories were more likely than those in the highest income categories to realize gains in net worth in excess of 100 percent. This phenomenon was attributed to the greater use of unsecured credit and lower ownership of nonexempt assets by the low-income petitioners relative to high income petitioners. Those petitioners who had unsecured debts making up 80-100 percent of total nonmortgage debts were more likely to realize gains in excess of 100 percent of net worth than those petitioners who held a greater percentage of secured credit. Finally, petitioners who could not have repaid more than 25 percent of their debts out of income within 36 months were more likely to realize gains in net worth in excess of 100 percent than those who could have repaid more than 25 percent of their debts.

IV. Ability to Obtain Credit After Bankrutpcy

Given the special exemption of assets granted persons filing bankruptcy, possibly one of the most significant expected costs of filing bankruptcy should be the loss of access to credit markets after bankruptcy. Each respondent was asked to indicate whether he or she thought that it would be more or less difficult to obtain credit from various sources in the future. The majority of respondents thought that it would be more difficult to obtain credit after bankruptcy from banks, thrift institutions, finance companies and retailers (Exhibit 3-12). Only about one-fifth of the sample expected credit to be more difficult

EXHIBIT 3-11

GAINS FROM BANKRUPTCY BY ABILITY TO REPAY DEBTS

	Percent Of Debts Repayable In 36 Months		
Percentage Change In Net Worth	Less Than 25%	25-75%	Greater Than 75%
Less than 25 percent	15.1	13.1	24.2
75 percent	4.6	8.1	5.9
76-100 percent	7.9	11.1	7.8
101-200 percent	58.0	48.5	44.2
Greater than 200 percent	14.2	19.2	18.0
	100.0%	100.0%	100.0%

$\chi^2 = 23.36$ Significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

to obtain from friends, family, coworkers, doctors and hospitals. Most respondents generally believed that there would be no change in the difficulty of getting credit from those sources in the future. The petitioners' expectations appear to be consistent with the facts that were displayed earlier--as those sources of credit were used at about the same rate as other petitioners by petitioners who were filing for bankruptcy for the second time. In general, credit from sellers of goods and services, where the finance charge may be embedded in the cost of goods, was not expected to be more difficult to obtain, and the facts suggest that that is true. However, credit does appear to be more difficult to get from financial institutions after bankruptcy.

The respondents were generally aware that filing for bankruptcy might affect their ability to get credit in the future. Almost 20 percent of the petitioners had been told by their lawyer or legal aid service that that was the case. The majority of respondents indicated that they just knew that to be the case (Exhibit 3-13).

V. Summary

One would expect the incidence of bankruptcy to be a function of the expected cost of bankruptcy. The costs considered in this chapter were expected losses of specific assets, changes in net worth resulting from bankruptcy, and expected difficulty in getting credit in the future.

About 60 percent of the petitioners did not expect to lose any assets in bankruptcy, either because the assets were exempt or because the petitioners planned to reaffirm the debt. An analysis of the exemptions claimed by each petitioner relative to exposed assets as

EXHIBIT 3-12

DIFFICULTY IN GETTING CREDIT IN THE FUTURE

	More Difficult	Less Difficult	No Change/ Same as Now	Don't Know	Total
Bank	62%	12%	12%	14%	100%
Savings & loan	53	9	11	17	100%
Credit union	45	11	17	27	100%
Finance company	62	10	11	17	100%
Retailer/dealer/contractor	55	11	15	19	100%
Friends/family/coworkers	15	13	60	12	100%
Doctor or hospital	23	11	48	18	100%

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

reported on the petition revealed that the petitioners' expectations of asset losses were consistent with the petition data. About two-thirds of the sample claimed exemptions that were at least 50 percent of their available assets. Slightly more than 21 percent listed exemptions that were at least equal to 100 percent of available assets. The rest of the sample was likely to lose some assets because exemptions were not sufficient to protect all available assets.

An analysis of the changes in wealth of the petitioners that was attributable to the act of taking bankruptcy shows that the gains from bankruptcy were, in general, more than 100 percent of net worth before bankruptcy. The distributions of changes in net worth was analyzed relative to coverage of assets by exemptions, income, debt portfolio characteristics, and exemption levels. The results indicate that the relative gains in wealth from bankruptcy were a significant function of the extent to which available assets were protected by exemptions. In addition, the percentage gains from bankruptcy were positively associated with the percent of unsecured credit in the consumer debt portfolio. Those who had the least ability to repay debts out of income were significantly more likely to experience very large gains in net worth than those who could have repaid some or most of their debts out of income. In the calculation of change in net worth, we assumed that nonexempt assets would be liquidated and the proceeds would be distributed to unsecured creditors. To the extent that creditors do not follow through on the liquidation procedures as specified by the law, the change in net worth actually realized by petitioners by filing for bankruptcy is understated,especially for high income consumers who have assets

EXHIBIT 3-13

SOURCE OF INFORMATION ABOUT FUTURE CREDIT AVAILABILITY

Article/book	3%
Newspaper/magazine	2
Radio/television	1
Lawyer/legal aid service	17
Friend/relative/coworker	11
Credit counseling service	1
Own idea/ just knew	42
Other	22
No response	7
	100%

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

unprotected by exemptions. In fact, we found that 490 petitioners declared exemptions that were less than three fourths of their available assets. If the creditors or the courts generally do not require that those nonexempt assets be liquidated in bankrutpcy, it is understandable that a considerable number of petitioners in our sample filed bankruptcy when our calculations showed no apparent wealth benefit of bankruptcy realized by those petitions.

The petitioners believed that there would be a detrimental effect of bankruptcy on their ability to get credit in the future. In addition, they perceived that their ability to get credit from lenders like banks and finance companies and retailers would be affected more than their ability to get credit from lenders like medical sources, and friends.

FOOTNOTES

[1] Claims with priority are claims that do not get absolved in bankruptcy such as taxes payable.

[2] This calculation of net worth ignores transactions costs of bankruptcy such as legal fees.

[3]

Income	Omitted Group	Included Group
< $5,000	70	167
$5,001 - 10,000	94	262
$10,001 - 15,000	79	217
$15,001 - 20,000	48	86
> $20,000	48	128
	339	860

$\chi^2 = 5.07$ Not significant at ten percent level of confidence

[4] $\chi^2 = 1.72$ Insignificant at ten percent level of confidence

[5] $\chi^2 = 3.97$ Significant at the ten percent level of confidence.

CHAPTER 4

EFFECT OF THE LEVEL OF ASSET EXEMPTIONS AND BANKRUPTCY JUDGES

I. Overview

The 1978 Bankruptcy Reform Act provided a uniform definition of exempted assets across states where previously the definition of exempted assets was determined by each state. The federal exemption level was high compared to that in many states, but could be overridden by specific state legislation (this action has been taken by 32 states to date). Thus, there exists a large amount of cross-state variation in the dollar amount of personal and household goods that is exempt in personal bankruptcy proceedings. This study was designed such that the effect of the exemption level on the bankruptcy phenomenon could be analyzed. Half of the sample came from states with low exemptions and half came from states with high exemptions.

The five low exemption states were a subset of those states that had overridden the federal exemption definition with lower exemption levels. The five high exemption states were selected from those states which had either not overridden the federal exemptions or had state exemptions that were higher than the federal exemption level. The homestead exemption was used as the basic criterion for determining whether a state had low or high exemptions.[1]

The homestead and personal property exemption for the low exemption states were:

State	Homestead	Personal Property	Jewelry
Georgia	$5,000	$200 per item or $3500 aggregate	$400
Illinois	$10,000	$300, plus $700 if head of family with whom he lives	Not specified
Louisiana	No dollar amount specified	general clothing and furnishings, no dollar amount specified	Not specified
Ohio	$5,000 real or personal property used as a residence	$200 per item; $400 cash on hand or money due	$400 for one item; $200 for each additional item
Virginia	$5,000 comprised of personal and real property, to be selected by him; veterans with at least 40% disability are entitled to an extra $2,000 exemption; plus clothing and furniture, etc.		Not specified except for wedding rings

The high exemption states operated under the federal exemption definition or had a state definition that was even higher than the federal definition. Those states were California, New York, Pennsylvania, Texas, and Wisconsin. The federal homestead exemption may not exceed $7,500 (per debtor) in real property or personal property that the debtor uses as a residence and $200 in value in any particular item of household furnishings, goods, wearing apparel, books, animals, crops, or musical instruments. No more than $500 in jewelry held for personal, family, or household use is exempt.[2]

Another factor that plays an important role in the personal bankruptcy process are the procedures followed by the presiding judge.

Different judges have very different ideas about the assets which should be listed on the petition. For example, in one court district where interviews were conducted, the judge did not believe that engagement and wedding rings should even be listed as assets on a petition. Additionally, the judge may influence a consumer's choice between a Chapter 7 bankruptcy or a Chapter 13. An analysis of decisions made by the judges in whose courts the data for this study were collected revealed that some judges approved very few Chapter 13s and all Chapter 7s over the three-month period before the interviews were taken (April-June 1981). The bankruptcy statistics for the judges in one court district included in the study indicated about 60 percent of petitioners were granted Chapter 7 relief. In contrast, in another court district 92 percent of personal bankruptcy cases were Chapter 7 cases. On average, Chapter 7 bankruptcies represented about 77 percent of personal bankruptcies filed in the 20 court districts included in this study for the three month period before the study data were collected. Nationally, the average was 73 percent. In the following chapter we analyze the effect of exemption levels and judges on the bankruptcy phenomenon.

II. Exemption Levels

A. Debtors' Choices Between Federal and State Exemptions

The petitioner may elect to file for bankruptcy under the exemption definition that is most advantageous. In some states on a joint petition, one petitioner may elect the federal and one may elect the state exemption. The choices of the petitioners in the sample grouped by low versus high exemption states were:

	Low Exemption States	High Exemption States
Federal Exemption 11 U.S. C522	21.7%	57.7%
State Exemption	47.8	18.4
Both Federal and State Exemptions	11.0	8.7
No Response	19.4	15.2
	100.0%	100.0%

In Chapter 3, we analyzed the decision to take bankruptcy as if it were like exercising a call option contract. By exercising the option to declare bankruptcy, the petitioner is buying his or her outstanding unsecured debt contracts for the dollar value of nonexempt assets owned. Thus, the higher the amount of assets exempted, the lower is the exercise price of the option. Holding other things constant, the higher the amount of assets exempted, the wealthier (in terms of assets) a petitioner can be and still pay a low price to exercise the option. We hypothesize that a greater percentage of petitioners in the high-exemption states would come from the highest income bracket (more than $20,000) than in the low exemption states. In addition, we hypothesize that the distribution of total assets for the petitioners in the low exemption states would differ from that for the petitioners in the high exemption states. These hypotheses were tested by an analysis of the distributions of before-tax family income and total assets in the two treatment areas. However, the fact that almost 22 percent of petitioners in the low exemption states filed under the federal exemption definition may have reduced our ability to identify an effect of the exemptions in this study.

B. Family Income

The distribution of total before-tax family income for petitioners in the low and high exemption states is shown in Exhibit 4.1. The income distributions were significantly different in the two treatment areas. In addition, there was a significant difference in the percent of petitioners in the highest income brackets in the two treatment areas.[3] Almost 18 percent of petitioners from the high exemption areas had annual family pre-tax income of more than $20,000 compared to almost 12 percent of petitioners in the low exemption areas. This difference supports our hypothesis that the higher the exemption level the lower the cost of bankruptcy for households with high income (and the accompanying high assets). Thus, high income households are more likely to exercise their option to take bankruptcy in high-exemption states than in low-exemption states.

An analysis of the income distributions of petitioners filing in the low exemption states under the federal specification of exemptions versus the state exemption specification indicated no significant difference in the income distributions of the two groups. This would suggest that the differences in the income distributions of petitioners in the low and high exemption states may be attributable to cost of living differences in the states included in the study. Further analysis of the effect of allowed exemptions on the bankruptcy phenomenon is currently being conducted with adjustments for differences in cost of living across states.

C. Total Assets

If the level of exemptions allowed in each state had no effect on the bankruptcy phenomenon one would expect to find that tht dollar value of assets listed by each petitioner would be independent of the allowed exemption level. However, if the petitioners and their lawyers are truthful and consistent in terms of the declaration of assets and asset valuation across treatment areas, then evidence of differences in the upper end of the distributions of assets of petitioners in the two areas support our hypothesis. The distributions of total assets listed in Schedule B (total assets claimed by the petitioner at the time of the bankruptcy filing) of each petition are shown in Exhibit 4-2. The distributions were significantly different at the ten percent level of confidence. A significantly larger percentage of the sample in the high exemption states had more than $50,000 in total assets than the sample from the low exemption states.[4]

One of the most significant assets in the portfolios of individuals is the home. In addition, homeownership is somewhat limited to families in the higher socio-economic categories. The data in Exhibit 4-2 show that 28 percent of the sample of petitioners in the high exemption states owned their own home relative to 25.3 percent in the low exemption states. However, this difference was not significant at the ten percent level of confidence.

D. Other Effects

An interesting phenomenon observed in the data base was the relationship between exemption levels and lawyer fees and the use of a lawyer. In the low exemption states the average fee paid to the lawyer

EXHIBIT 4-1

ANNUAL BEFORE-TAX FAMILY INCOME

	Low Exemption	High Exemption
Number of cases	598	601
Income		
\$0 - 5,000	20.9%	18.7%
\$5,001 - 10,000	32.3	27.1
\$10,001 - 15,000	25.3	24.1
\$15,001 - 20,000	10.0	12.3
> \$20,000	11.5	17.8
	100.0%	100.0%

$\chi^2 = 13.02$ Significant at ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

EXHIBIT 4-2

EXEMPTION LEVELS AND TOTAL ASSETS OF PETITIONER

Total Assets	Low Exemption	High Exemption
Less than $5,000	59.7%	46.9%
$5,001 - 20,000	19.2	27.0
20,001 - 50,000	14.2	14.3
More than $50,000	6.9	11.8
	100.0%	100.0%

χ^2 = 24.81 Significant at ten percent level of confidence.

Home Ownership		
Own home	25.3	28.0
Rent	62.4	63.6
Neither/other	12.3	8.3
	100.0%	100.0%

χ^2 = 5.66 Significant at ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

for bankruptcy council was $342. In the high exemption states the average was $422, a difference of $80. This phenomenon could reflect the fact that in high exemption states the change in net worth resulting from bankruptcy was significantly higher than that in the low exemption states (see Chapter 3). Consequently, people paid more to a lawyer to gain that benefit in the high exemption states. However, demand for lawyers' bankruptcy services exhibited price elasticity as fewer petitioners used a lawyer in the high exemption states (92 percent) than in the low exemption states (98.5 percent).

E. Ability to Repay

One would expect consumers to choose to take bankruptcy when they were technically solvent or when they were able to repay their debts, when the benefits of bankruptcy after transactions costs were positive. In Chapter 3, we showed that the distributions of percentage gains in wealth were significantly different in the high exemption versus low exemption states. However, an analysis of the nonmortgage debt-to-pretax family income ratio (Exhibit 4-3) indicates that the distributions of the ratio in the two treatment areas were not significantly different. In both areas, almost 50 percent of petitioners had consumer debt that was greater than 100 percent of before-tax family income. The higher exemption level makes it possible for consumers with a fairly large amount of assets and income to declare bankruptcy at a lower cost in terms of assets lost. However, those same consumers had evidently amassed large quantities of debts, perhaps to acquire those assets. Thus, the ability of petitioners in the high exemption states to repay their debts out of income was insignificantly different from that for petitioners in the low exemption areas.

EXHIBIT 4-3

ABILITY TO REPAY EXEMPTION LEVEL

Ratio Of Nonmortgage Debt-To-Income	Low Exemption	High Exemption
Not ascertained	7%	6%
0-25 percent	15	12
25-50 percent	19	14
51-75 percent	11	13
More than 100 percent	48	50
	100%	100%

$\chi^2 = 5.08$ Insignificant at the ten percent level of confidence

	Portion of Nonmortgage Debts Repayable in 36 Months:		
	Less Than 25%	25-75%	Greater Than 75%
Low exemption	66.1	10.5	23.4
High exemption	64.6	12.3	23.1

$\chi^2 = .94$ Insignificant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

III. Effect of the Presiding Judge

The judge who presides in the bankruptcy court may influence a petitioner's choice between Chapter 7 or Chapter 13. It was learned in the process of data collection for this study that the judges' preferences with regard to Chapter 7 vs. Chapter 13 and with regard to the proper declaration of assets are quickly assimilated by lawyers appearing in court. This information in turn is conveyed to the petitioners seeking debtor relief. Recall that 21 percent of the petitioners in our sample who knew about Chapter 13 had been advised against taking it by their lawyers.

Of particular interest in this study is the way that the court handles Chapter 7 vs. Chapter 13 cases. It is clear from Exhibit 4-4 that some judges in our study areas hardly ever approved a Chapter 13 case (Western Pennsylvania). In other court districts, the judges maintained more balance between Chapter 7 and Chapter 13 cases. However, in none of our study districts did the judges collectively approve as many Chapter 13s as Chapter 7s.[5]

The proposed change in the bankruptcy law would mandate an entrance requirement to Chapter 7 such that the extent to which affordable debts were being excused in bankruptcy court would be reduced. We hypothesized that those judges who had a relatively low percentage of Chapter 7 cases in their courts were already imposing an informal "needs" test. If the judge limited the petitioner's ability to take a straight bankruptcy unless he or she truly could not repay debts in the specified period, he was already operating his court as it would be mandated under the proposed change in the law. As a result, we hypothesize that a smaller percentage

EXHIBIT 4-4

CHAPTER 7 AS PERCENT OF TOTAL PERSONAL BANKRUPTCIES

(APRIL - JUNE 1981)

Court District	Chapter 7	Chapter 13	Chapter 7 As Percent of Total
1 Northern Georgia	1004	629	61%
2 Middle Georgia	485	201	71
3 Northern Illinois*	2561	1737	60
4 Central Illinois	1047	129	89
5 Eastern Louisiana	505	85	86
6 Western Louisiana	408	121	77
7 Northern Ohio	2753	904	75
8 Southern Ohio	2169	880	71
9 Eastern Virginia*	1456	192	88
10 Western Virginia	604	190	76
11 Central California*	4897	827	86
12 Northern California	2316	904	72
13 Northern New York	1179	124	90
14 Western New York	1209	321	79
15 Central Pennsylvania	802	518	61
16 Western Pennsylvania	917	85	92
17 Northern Texas*	487	183	73
18 Western Texas	345	224	61
19 Eastern Wisconsin	865	99	90
20 Western Wisconsin	430	116	79

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*U.S. Court District

SOURCE: Administrative Office of the U.S. Courts, Bankruptcy Division.

of Chapter 7 cases in those courts relative to the more liberal courts would have been excused of affordable debts. We selected those court districts from our study sample where Chapter 7 bankruptcies make up a relatively low percent of total bankruptcies and evaluated them as if they were test cases of the proposed change in the law.

The four court districts that had the lowest percent of Chapter 7 bankruptcies in our study courts were Northern Georgia (61 percent), Northern Illinois (60 percent), Central Pennsylvania (61 percent), and Western Texas (61 percent). We contrasted the petitioners from these courts (strict) to those from the four courts that had the highest number of Chapter 7's relative to total personal bankruptcies (lenient). They were Central Illinois (89 percent), Northern New York (90 percent), Western Pennsylvania (92 percent) and Eastern Wisconsin (90 percent).

The first comparison made was that of the ability of the petitioners to repay their nonmortgage, nonbusiness debts in three years out of current disposable income. The distributions of that variable for the petitioners in the strict court districts versus those in the lenient court districts are shown in Exhibit 4-5.

As we hypothesized, the petitioners for Chapter 7 who were processed in courts where the judges approved a smaller number of Chapter 7 cases relative to total personal bankruptcies (strict) were slightly less likely to be classified as able to repay 75 percent or more of their debts than those petitioners who were processed in the more lenient courts. However, the difference in the distributions was not significant. We next analyzed the income distributions of petitioners in the two

EXHIBIT 4-5

ABILITY TO REPAY BY COURT DISTRICT

N=489

	Percent of Debt Repayable in 36 Months		
Court District	Less Than 25 Percent	25-75 Percent	More Than 75 Percent
Strict	70.7%	9.3%	19.9%
Lenient	69.1%	9.5%	21.4%

$\chi^2 = .176$ Not significant at ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

treatment groups. Those distributions are shown in Exhibit 4-6. Chapter 7 petitioners in the strict court districts were more likely to fall in the lowest income categories than petitioners in the lenient court districts. However, again, the distributions were not significantly different.

The differences here were not significant but the variance in the percentage of Chapter 7 to total personal bankruptcies for our study districts was not large (60 percent - 92 percent). An additional factor that weakens these tests is the fact that there were several judges presiding in each of our study districts. Within the districts there was considerable variation across judges in terms of the percentage of decisions that resulted in Chapter 7 bankruptcy versus Chapter 13. A stronger test of our hypothesis would involve tests at the level of judge rather than at the level of bankruptcy district. However, we were not able to associate petitioners with specific judges in our data base.

IV. Summary

One of the more important provisions in the Bankruptcy Reform Act of 1978 was the one that imposed a federal definition of assets exempt from liquidation in bankruptcy. The federal definition allowed for the protection of a greater dollar value of personal assets relative to that allowed in some states. The federal definition could be overridden at the state level and was in 32 states. In this study, we selected half our sample from states with relatively low exemptions and half from states with high exemptions to test the effect of the exemption level on the bankruptcy phenomenon.

EXHIBIT 4-6

INCOME GROUPS BY COURT DISTRICTS

N = 489

	Before-Tax Income				
	Less Than $5,000	$5,001-10,000	$10,001-15,000	$15,001-20,000	Greater Than $20,000
Strict	21.5%	32.5%	25.2%	8.5%	12.2%
Lenient	19.3	28.4	26.3	10.7	15.2

$\chi^2 = 2.45$ Not significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

We hypothesized that the higher the value of assets exempted, the wealthier a petitioner could be and still suffer little loss in terms of assets. The distributions of income and assets in the two test areas were significantly different at the ten percent level. A significantly greater percentage of petitioners in the high exemption states fell in the highest income and asset categories than petitioners in the low exemption states. Further analysis of this phenomenon is required with adjustments for differences in the cost of living across states.

We also tested for the effect of the strictness of bankruptcy judges on the bankruptcy phenomenon. We hypothesized that in those districts where a Chapter 7 decision was more difficult to get, there would be relatively fewer consumers winning Chapter 7 judgments who could have repaid all or most of their debts. The tests did not support our hypothesis.

In conclusion, the exemption level defines the value of assets a petitioner can possess and still take bankruptcy at a low cost. The implication of this characteristics of personal bankruptcy legislation is that the number of households in a state who could be expected to file for bankruptcy is likely to be a function of the percent of households who have income and assets below some cut-off point that is related to the definition of asset exemptions which applies in that state.

FOOTNOTES

[1] See Monograph No. 23, Credit Research Center, Purdue University; Chapter 2, for a more detailed discussion of the selection criterion used.

[2] The Compliance Handbook for Consumer Bankruptcy, prepared by the editors of Washington Credit Letter, 1980, p. 54.

[3] $X^2 = 22.40$ Significant at the ten percent level of confidence.

[4] $X^2 = 8.86$ Significant at the ten percent level of confidence.

[5] For the nation as a whole, Chapter 13s represented 27 percent of personal nonbusiness debt relief petitions filed in 1980.

CHAPTER 5

EFFECT OF THE PROPOSED CHANGE IN THE FEDERAL BANKRUPTCY LAW ON PETITIONERS FOR BANKRUPTCY

It has been proposed that the existing federal bankruptcy legislation be changed such that those petitioners who could afford to repay a reasonable portion of their debts from anticipated income would be denied access to Chapter 7. If they wish to get protection from their creditors while they were repaying a percentage of their debt they could file for Chapter 13. In other words, there would be a "needs" test that must be satisfied before a Chapter 7 bankruptcy would be approved. The petitioner's ability to repay his or her debts would be determined by the bankruptcy courts on the basis of income available after taxes and reasonable living expenses. In this study, we estimated the petitioners' ability to repay their debts out of current and future income given basic living expenses.[1] In this section, we will analyze the demographic profile of those who could have repaid some or all of their nonmortgage debts relative to those who could not have done so according to our definition. This analysis provides necessary insight into the characteristics of those who would be most affected by the proposed change in the law. In addition, we compare the causes of bankrutpcy, alternatives to bankruptcy and history of past bankruptcy for the petitioners grouped by ability to repay debts out of anticipated income.

I. Ability to Repay

The ability of a petitioner to repay his or her debts out of income was calculated by finding the amount of monthly income after taxes and living expenses that would be available to repay existing nonmortgage, nonbusiness debts. Living expenses were the sum of actual current housing expenses supplied on the questionnaire including property taxes and insurance, utilities, the basic nonhousing living expenses per person for a family at the poverty level, and the excess current monthly medical, child care, and alimony expenses as indicated by the petitioner on the questionnaire. These expenses were subtracted from income after income and social security taxes to obtain the amount of monthly income available to repay debts. Given that amount, the percentage of debts that could be repaid over a 36-month period was calculated.[2] Those petitioners who could have repaid less than 25 percent of their debts within 36 months made up 65 percent of the sample. Those who could have repaid 25 to 75 percent made up 11 percent of petitioners and the other 23 percent could have repaid more than 75 percent of their nonmortgage debts within three years, assuming annual family income stayed at least at the level reported on the questionnaire. We assumed that those who could repay less than 25 percent of their debts in 36 months would be directed by the court to take Chapter 7 under the proposed change in bankruptcy legislation. We assumed that the other 35 percent of the sample would be denied admission to Chapter 13.[3]

II. Demographic and Economic Characteristics

A. Life Cycle

The life cycle characteristics of the petitioners grouped by ability to repay debts in 36 months (less than 25 percent, 25-75 percent, greater than 75 percent) are summarized in Exhibit 5-1. The most notable difference in the life cycle characteristics of the groups is that those who could have repaid 75 percent or more of their debts were more likely to be young and single with no children than those who could have repaid less than 25 percent of debts outstanding. This is further confirmed in Exhibit 5-2 where the distribution by marital status is shown. Those who could have repaid 75 percent or more of their debts were almost 30 percent more likely to have never been married than those who could have repaid less than 25 percent of their debts. Those who could have repaid some of their debts (25-75 percent, greater than 75 percent) had fewer dependents (2.9 compared to an average of 3.2) than those who could have repaid less than 25 percent of debts. Thus, these data suggest that those petitioners who would be required to attempt to repay some of their debts had fewer family obligations and were younger than those who would be approved to take Chapter 7. In general, the life cycle distributions for the three groups were not significantly different. However, comparisons of the two extreme groups did show differences in life cycle characteristics.

B. Before-Tax Family Income

The distributions of current before-tax family income of the petitioners were analyzed relative to ability to repay. We found that the distributions of petitioners' income in each group were significantly

EXHIBIT 5-1

LIFE CYCLE

	Portion Of Debts Repayable In 36 Months					
	Less Than 25%		25-75%		Greater Than 75%	
Number of cases	783		137		279	
Less than 45 years old		68.6		73.6		70.3
Single - no children	14.3		13.1		17.6	
Married						
No children	11.0		13.1		11.5	
Children < 6 years	28.5		32.8		29.0	
Children > 6 years	14.8		14.6		12.2	
45 years old or older		14.5		16.1		13.1
Single - no children	3.0		2.9		4.0	
Married						
No children	4.5		6.6		5.5	
Children	7.0		6.6		3.6	
Single with children	15.2	15.2	9.5	9.5	16.1	16.1
Missing values	1.7	1.7	.8	.8	.5	.5
		100.0%		100.0%		100.0%

$\chi^2 = 23.03$ Not significant at ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

EXHIBIT 5-2

MARITAL STATUS

	Percent of Debts Repayable in 36 Months		
	Less Than 25%	25-75%	Greater Than 75%
Number of cases	783	137	279
Married	56.6%	65.0%	54.5%
Separated	9.2	8.0	6.8
Divorced	20.1	17.5	22.2
Living as married	1.5	1.5	1.1
Single - never married	10.6	7.3	13.6
Widowed	1.9	.7	1.8
No response	0	0	0
	100.0%	100.0%	100.0%

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

different. Generally, those who could have repaid more than 25 percent of their debts were more likely to have higher income than those who could have repaid less than 25 percent (Exhibit 5-3). A fourth of the petitioners who could have repaid 25 percent or more of their nonmortgage debts reported family income greater than $20,000. Almost 17 percent of those who could not have repaid their debts reported less than $5,000 in total before-tax family income while an average of 3.4 percent of those who could have repaid reported less than $5,000 in income. Only slightly more than eight percent of those who could not have repaid their debts fell in the highest income category.

A further indication of the degree of financial distress being experienced by the petitioners was their dependence on the federal food stamp program. Fourteen percent of the total sample received food stamps in the month before filing their bankruptcy petition. Eighteen percent of those petitioners who could not have repaid a significant amount of their debts over 36 months reported that they had received food stamps in the month before the survey was taken. Only about three percent of those who could have repaid some of their debts received food stamps. Those consumers seeking debtor relief who would have been required to repay some of their debts under the proposed law generally had significantly greater financial ability to do so than those who would have been allowed to take straight bankruptcy.

Those who could have repaid some of their debts were more likely to be currently employed and to have professional or managerial jobs than those who could not have repaid (Exhibit 5-4). They also had

EXHIBIT 5-3

TOTAL BEFORE-TAX FAMILY INCOME

	Portion of Debts Repayable in 36 Months		
Total Family Income (before tax)	Less Than 25%	25-75%	Greater Than 75%
Number of cases	783	137	279
Less than $5,000	16.6%	5.2%	2.5%
$5,001 - 10,000	36.7	21.9	14.0
$10,001 - 15,000	21.2	35.0	29.4
$15,001 - 20,000	5.4	20.4	22.9
Greater than $20,000	8.4	17.5	30.8
Not ascertained	11.7	0	.4
	100.0%	100.0%	100.0%

$\chi^2 = 277.51$ Significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

EXHIBIT 5-4

OCCUPATION-HEAD OF HOUSEHOLD

	Portion of Nonmortgage Debts Repayable in 36 Months		
	Less Than 25%	25-75%	Greater Than 75%
Number of cases	783	137	279
Professional or technical	4.7	10.2	12.9
Managerial, official or proprietor	6.1	9.5	8.6
Clerical	7.5	10.2	7.9
Sales	4.9	5.1	5.7
Craftsman, foreman	17.9	23.4	24.0
Operatives	9.2	6.6	10.0
Service workers	12.0	12.4	6.5
Laborers	9.5	8.0	11.5
Others	1.9	3.6	2.5
No response[1]	26.3	10.9	10.4
	100.0%	100.0%	100.0%

$X^2 = 72.81$ Significant at the ten percent level of confidence.

[1] Includes those who were not currently employed.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

significantly more education than those in the 25 percent-or-less category (Exhibit 5-5). Of those who could have repaid some or all their nonmortgage debts in 36 months, 38 percent had some college education or more compared to only 30 percent of the nonpaying group. Nonetheless, those who could have repaid some portion of their nonmortgage, nonbusiness debts were not significantly more optimistic about the expected growth in their income in the next year than those who could have repaid less than 25 percent of nonmortgage debts out of current income (Exhibit 5-6).

III. Causes of Bankruptcy

The petitioners who could have repaid some of their debts (25-75 percent, greater than 75 percent) were more likely to have cited overuse of credit or easy credit as one of the most important cause of bankruptcy than those who could not have repaid their debts in 36 months (Exhibit 5-7). Those who could have repaid most of their debts were also less likely to attribute their financial problems to loss of job than the rest of the sample.

A different view of the most frequently mentioned "most important" causes of bankruptcy cited by the petitioners is provided in Exhibit 5-8. Two-thirds of the sample in general were deemed as lacking the financial resources to repay their nonmortgage debts. This group included three-fourths of those who cited medical bills as one of the most important cause of bankruptcy; 81 percent of those who cited loss of job; and 71 percent of those who cited marital problems. Thus, it appears that those who attributed their financial distress to medical bills, marital problems or loss of job were much more likely than petitioners in general to lack

EXHIBIT 5-5

EDUCATION-HEAD OF HOUSEHOLD

Education	Portion of Nonmortgage Debts Repayable in 36 Months		
	Less Than 25%	25-75%	Greater Than 75%
Number of cases	783	137	279
Did not finish high school	26.7%	20.4%	20.4%
High school graduate	32.2	31.4	32.6
Training or vocational school	7.7	6.6	7.9
Attended college courses	22.1	26.3	25.9
College graduate	6.0	10.9	7.2
Advanced college degree	2.3	2.9	3.9
No response	3.0	3.6	2.9
	100.0%	100.0%	100.0%

$\chi^2 = 18.02$ Not significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

EXHIBIT 5-6

EXPECTED FUTURE INCOME

Expected Change In Income In Next Year:	Portion of Debts Repayable in 36 Months Less Than 25%	25-75%	Greater Than 75%
Number of cases	783	137	279
Definitely higher	24.5%	24.1%	27.1%
Probably higher	28.2	26.3	26.4
About the same	6.5	3.8	6.6
Probably lower	3.8	3.0	5.5
Definitely lower	36.9	42.9	34.4
	100.0%	100.0%	100.0%

$\chi^2 = 5.93$ Not significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

EXHIBIT 5-7

MOST IMPORTANT CAUSES OF BANKRUPTCY

	Portion of Debts Repayable in 36 Months		
	Less Than 25%	25-75%	Greater Than 75%
Number of cases	783	137	279
Personal			
Medical bills	16%*	14%*	15%*
Marital problems	12	13 *	14 *
Natural disaster	0	0	0
Death in family	1	0	1
Addiction	1	0	1
Employment			
Cutback in hours	6	2	4
Laid off/fired	14*	7	8
Own business failed	8	10	4
Employer's business failed	2	2	2
Unable to work	8	6	4
Lost second income	4	3	5
Credit Problems			
Used excess credit	12*	14*	18*
Credit too easy to get	2	7	8
Creditors would not cooperate	4	4	4
Creditors attempted to collect	4	3	4
Sued by creditors	5	4	4
Wages garnished	4	3	4
Property repossessed	1	0	1
Cosigned on loan	1	2	1
Cost of living went up	7	5	1
Other reasons	8	12	7

*Three most frequently mentioned causes

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

EXHIBIT 5-8

MOST IMPORTANT REASON

Most Important Cause	Portion of Debts Repayable in 36 Months Less than 25%	25-75%	Greater Than 75%
Medical bills	75%	9%	16%
Marital problems	71	7	22
Laid off/fired	81	6	14
Too much credit	63	14	22
Total sample	65%	11%	23%

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

the financial means to repay their debts. The same statement could not be made for those who cited excess use of credit as the most important cause of bankruptcy.

Those who could have repaid some of their debts were significantly more likely to report that they filed for bankruptcy to avoid paying certain creditors than the rest of the sample (Exhibit 5-9). An analysis of the sources of unsecured credit used by the various groups (Exhibit 5-12) revealed that those who could have repaid more than three-fourths of their nonmortgage debts were more likely than the rest of the sample to have loans from a bank or finance company. We indicated earlier that in general those who filed bankruptcy to avoid paying certain creditors most frequently indicated that they wanted to avoid a finance company or a bank.

Although those who could have repaid more than three-fourths of their debts had a more negative attitude toward creditors, they were less likely to report that particular creditor actions had been taken against them than the rest of the sample (Exhibit 5-10). In fact, they were more likely than the rest of the sample to report that no creditor action had been taken against them before they petitioned for bankruptcy.

An analysis of the proportion of unsecured debt relative to total consumer debt in the portfolios of petitioners grouped by ability to repay showed that there were no significant differences in the use of unsecured credit across the groups. The bulk of the petitioners in each group had unsecured credit that comprised 80-100 percent of their total consumer credit portfolio (Exhibit 5-11).

EXHIBIT 5-9

ABILITY TO REPAY DEBTS IN 36 MONTHS BY ATTITUDE TOWARD PAYING CREDITORS

Percent Who Filed To Avoid Certain Creditors	Portion of Debts Repayable in 36 Months		
	Less Than 25%	25-75%	Greater Than 75%
Number of cases	783	137	278
Yes	37.3%	40.1%	44.7%
No	62.7	59.9	55.3
	100.0%	100.0%	100.0%

$\chi^2 = 4.69$ Significant at the ten percent level of confidence.

Data reflect responses to the question: In talking with other people who have declared bankruptcy we have found some who told us that one of the reasons they declare bankruptcy was not so much to cancel all their debts as it was to avoid one or more specific creditors. Would you say that this situation applies to you?

SOURCE: Credit Research Center, Purdue Univeristy, Consumer Bankruptcy Study.

EXHIBIT 5-10

ACTIONS TAKEN BY CREDITORS TO COLLECT LOAN

	Percent of Debt Repayable in 36 Months		
	Less Than 25%	25-75%	Greater Than 75%
Number of cases	783	137	279
Actions:			
Threaten repossession	45%	34%	42%
Repossessed collateral	21	13	18
Sought deficiency judgment	13	9	13
Threatened foreclosure	15	11	9
Foreclosed on home	4	2	3
Threatened garnishment	42	40	39
Garnished wages	20	17	16
Telephoned frequently	80	81	74
Visits to home or work	32	20	24
Threatening letters	70	74	71
Contacted cosigner	10	6	8
Contacted employer	29	26	25
Contacted relative	31	23	29
No action taken	5	4	8

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

EXHIBIT 5-11

DEBT PORTFOLIO CHARACTERISTICS

Ratio of Unsecured Debt, Nonmortgage to Total Debt	Portion of Debts Repayable in 36 Months: Less Than 25%	25-75%	Greater Than 75%
0-20 percent	7.9%	5.8%	5.0%
21-40 percent	12.4	13.1	10.4
41-60 percent	12.4	19.0	17.6
61-80 percent	18.1	19.7	22.2
81-100 percent	44.1	39.4	40.5
Missing	5.1	2.9	4.3
	100.0%	100.0%	100.0%
Average:	63.1%	63.3%	64.4%

$\chi^2 = 13.87$ Not significant at the ten percent level of confidence.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

The analysis of the sources of unsecured credit used by the petitioners in each group (Exhibit 5-12) suggests that the source of credit used did not differ markedly across the groups except for the use of medical credit. Those who could have repaid more than three-fourths of their debts were less likely to have medical credit than those in the other two groups. However, the petitioners in the highest ability group were less likely to have filed for bankruptcy because of medical bills than those in the group with the least ability to repay debts. In addition, the average amount of loan from each source was usually several hundreds of dollars lower for those who could have repaid 75 percent or more of their debts than for those who could not have repaid their debts. This differential characterized the debt owed to banks, finance companies, dealers, friends, and others.

IV. Alternatives to Bankruptcy

Those petitioners who could have repaid some of their debts were more likely than the rest of the sample to have heard of credit counseling, consolidation loans and rearranging payments (Exhibit 5-13). The percentage of each group who knew about and tried the various alternatives to bankruptcy was about the same across groups. The petitioners who could have repaid more than three-fourths of their debts were also more likely to have reported that they had heard about Chapter 13 than the rest of the sample.

EXHIBIT 5-12

SOURCES OF UNSECURED CREDIT

Source of Credit		Portion of Nonmortgage Debts Repayable in 36 Months		
		Less Than 25%	25-75%	Greater Than 75%
Bank:	a. % with loan	55%	66%	62%
	b. # of loans	2.07	2.32	2.06
	c. Average balance	$2197	$2310	$1296
Credit Union:	a. % with loan	16%	19%	18%
	b. # of loans	1.23	1.42	1.16
	c. Average balance	$1608	$1488	$1660
Finance Company:	a. % with loan	39%	41%	44%
	b. # of loans	1.66	1.41	1.83
	c. Average balance	$1865	$1311	$1138
Retailers:	a. % with loan	76%	79%	78%
	b. # of loans	3.82	4.33	3.53
	c. Average balance	$476	$441	$527
Dealers:	a. % with loan	25%	28%	19%
	b. # of loans	4.94	4.67	3.23
	c. Average balance	$1193	$897	$546
Medical:	a. % with loan	63%	62%	53%
	b. # of loans	4.73	4.56	4.02
	c. Average balance	$393	$455	$393
Friends:	a. % with loan	13%	21%	8%
	b. # of loans	2.03	2.07	1.50
	*c. Average balance	*$5168	$3705	$2194
Others:	a. % with loans	73%	72%	74%
	b. # of loans	4.50	3.73	3.11
	c. Average balance	$1672	$2147	$623

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*Excluding one case for $1,501,000 owed on a libel suit.

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

EXHIBIT 5-13

ALTERNATIVES TO BANKRUPTCY CONSIDERED AND TRIED

	Portion of Debts Repayable in 36 Months		
	Less than 25%	25-75%	Greater Than 75%
Number of cases	783	137	279
Heard of:			
Credit counseling	58%	60%	71%
Debt consolidation loans	80	88	84
Selling assets	76	76	72
Rearranging payments	80	80	82
Chapter 13	59%	61%	66%
Of those who heard, who tried:			
Credit counseling	60%	52%	61%
Debt consolidation loans	49	52	52
Selling assets	39	37	32
Rearranging payments	85%	83%	83%

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

V. Recurrent Bankruptcy

The petitioners who could have repaid almost all of their debts (greater than 75 percent) were more likely than the rest of the sample to report that they would consider filing for bankruptcy again the future (Exhibit 5-14). However, those who could not have repaid a significant portion of the debts had the highest incidence of at least one previous bankruptcy (11.6 percent).

VI. Summary

An effect of the current bankruptcy law which specifies no restrictions on admission to Chapter 7 is that consumers who had the financial ability to repay some of their debts had their debts discharged. Given the definition of ability to repay used in this study, the petitioners were grouped by the percent of their debts that could have been repaid in 36 months out of current income (less than 25 percent, 25-75 percent, greater than 75 percent). Almost 35 percent of petitioners could have repaid some or all their nonmortgage, nonbusiness debts within a 36 month period (25-75 percent, greater than 75 percent). Analysis of those consumers who could have repaid some or all of their debts revealed that a large percentage were young, single consumers. The distribution of income for those who could have repaid a significant percentage of their debts showed that they were more likely to fall in the high income categories than those who could not have repaid their debts. In addition, their ability to earn in the future measured by education and occupation was considerably more attactive than that of the group that could have repaid less than 25 percent of debts. We conclude from this analysis of demographic characteristics of the petitioner groups that

EXHIBIT 5-14

ATTITUDE TOWARD FILING FOR BANKRUPTCY AGAIN

	Portion of Debts Repayable in 36 Months		
	Less Than 25%	25-75%	Greater Than 75%
Legal to file for bankruptcy again?			
Yes	91.2%	97.0%	94.6%
Would you consider bankruptcy again?			
Yes	15.0%	10.4%	17.4%
No	46.7	46.2	40.6
Don't expect any more problems	14.0	15.1	15.0
Don't intend to let this happen again	24.3	28.3	27.1
	100.0%	100.0%	100.0%
	Previous Bankruptcy		
Have filed before	11.6%	10.4%	8.8%

SOURCE: Credit Research Center, Purdue University, Consumer Bankruptcy Study.

the proposed change in the bankruptcy law will not place an intolerable burden on poor down-trodden consumers who have little prospect for improving their financial situations.

The debt portfolios of the three groups of petitioners had basically the same characteristics with regard to portion of unsecured credit and sources used. However, those petitioners who could repay most of their debts had smaller amounts of unsecured credit from most sources used.

A comparison of causes of bankruptcy across the three groups indicated that those who could have repaid the bulk of their debts were much more likely to have cited abuse of credit and much less likely to have suffered loss of employment than the group who could have repaid only a small percentage, if any, of their outstanding debts. Those petitioners who cited marital problems, medical bills, and loss of job were more likely than the population in general, to be classified as having little ability to repay their debts.

The petitioners who could have repaid 75 percent or more of their debts were the least likely of the three groups to have previously filed for bankruptcy, but were the most likely of the three groups to indicate that they would consider filing for bankruptcy again. Considering the increase in wealth that was realized by most of these petitioners, one should not be surprised that they would consider tapping that source of enrichment as often as the law would allow.

FOOTNOTES

[1] See Monograph 23, Credit Research Center, Purdue University; Chapter 3 for a description of the specific details of the calculation of ability to repay debts.

[2] The percentage of debts that were repayable within 36, 48, and 60 months were calculated and discussed in Monograph 23.

[3] See Monograph 23, Chapter 4 for an analysis of the amount of debts recovered under these assumptions.

[4] Test of education differences in lowest and highest groups by ability to repay

	Less Than 25%	Greater Than 75%
Less than high school	27.5%	21.0%
High school-vocational school	41.1	41.6
Some college or more	31.4	37.4
	100.0%	100.0%

$\chi^2 = 5.30$ Significant at the ten percent level of confidence.

CHAPTER 6

CONCLUSIONS AND IMPLICATIONS

I. Characteristics of Chapter 7 Petitioners

In this monograph, the causes, costs, and benefits of personal bankruptcy for a sample of consumers petitioning for bankruptcy in mid-1981 under Chapter 7 of the Bankruptcy Reform Act were analyzed. The results of the study show that the typical petitioner for bankruptcy was a head of household, between the ages of 25 and 34, with small children, holding a high school degree and employed in an unskilled or semiskilled position in the labor force. The typical petitioner had consumer debts that exceeded the amount of annual before-tax family income and could have reapid less than 25 percent of nonmortgage debts out of income after expenses within a 36-month period. In considerable contrast to that image of the typical petitioner for bankruptcy, we found a significant subgroup of petitioners in our sample who had nonmortgage debts that were less than 50 percent of annual before-tax income and who could have repaid 75 percent or more of those debts out of income within 36 months.

The most important self-perceived causes of bankruptcy were medical bills, marital problems, loss of job, or excess use of credit. Many petitioners indicated that they had filed to avoid repaying a particular creditor and were most likely to indicate that they did not want to repay a bank or a finance company.

About 63 percent of the debts in the portfolios of the petitioners was unsecured with many petitioners having unsecured credit that made up 100 percent of their consumer debts. The average petitioner had 12.27 different unsecured obligations. Twenty percent of the total dollar value of unsecured debt in the portfolios of the petitioners came from banks, 21 percent from retailers and dealers, nine percent from medical sources and nine percent from consumer finance companies.

The bulk of nonmortgage secured credit in the portfolios of the petitioners was secured by an automobile or household furniture and appliances. Only 27 percent of petitioners owned their own home. All homeowners had a mortgage on their principal residence that was equal, on average, to 66 percent of the declared market value of the residence. Only nineteen percent of the petitioners who owned a home had a second mortgage loan.

From the information contained in the study on the sources and amounts of credit used by petitioners, one is led to the conclusion that the consumer credit market, with its current fractionalized structure and information system, cannot keep a consumer from using an excess amount of consumer credit, given the level and stability of the individual's income. Consumers petitioning for bankruptcy used large amounts of unsecured credit from many different sources, especially sellers of goods and services. Much of this credit is unlikely to be reported on a credit report. Therefore, unless a consumer provides complete information about his or her total outstanding debts on a credit application, a creditor considering a credit applicant has an incomplete assessment of the applicant's financial position.

II. The Costs of Bankruptcy

One of the primary forces that would motivate a consumer to limit credit use to a manageable amount given the uncertainty of future income and risk preferences would be the expected costs of bankruptcy. The results of our analysis suggest that most petitioners expected to lose very little in the way of assets by filing for bankruptcy. In addition, our calculations of petitioners' net worth before and after bankruptcy indicated that most of the petitioners enjoyed a very sizeable increase in wealth as a result of filing for bankruptcy. The petitioners generally expected credit to be more difficult to obtain after bankruptcy. However, they believed that many sources of credit, especially sellers of goods and services, would continue to be accessible to them. An analysis of the debt portfolios of petitioners in our sample who were filing for bankruptcy for a least the second time indicated that the types and amounts of consumer credit used after a bankruptcy were not significantly different from those used before bankruptcy. Thus, loss of access to credit markets may not be a significant cost of bankruptcy either in perception or practice. Our study suggests that the expected costs of bankruptcy may not be prohibitive enough to motivate consumers to limit their use of credit to an amount that is manageable.

If the expected costs of bankruptcy were sufficiently prohibitive, a consumer with serious financial problems would try less expensive alternatives to bankruptcy before filing. The petitioners in our sample had heard of and tried alternatives to bankruptcy. Only eight percent had not tried any of the alternatives to bankruptcy investigated in the study. However, the benefit of one of the most obvious alternatives to bankruptcy, credit counseling, may not be well known. For example, consumers can go to credit counseling to halt the collection activities of creditors. More than half of the petitioners had heard of credit counseling but only twenty percent had tried it.

One could argue that the financial problems of those consumers who appear in bankruptcy court may be too severe to be solved by counseling and many of the respondents in our study expressed this opinion. However, 18 percent of the sample had nonmortgage debts that were less than 50 percent of annual before-tax income which is about the average for consumers who do go to credit counseling. Presumably these consumers chose bankruptcy over credit counseling because the expected costs were less, holding benefits constant.

III. Effect of 1978 Bankruptcy Reform Act on Costs of Bankruptcy

A. Property Exemptions

One of the purposes of our study was to analyze the facets of the new bankruptcy law that may actually encourage the exercise of the option to take personal bankruptcy. One of the provisions of the bankruptcy law that the study was designed to analyze was the level of exempted assets. Consumers are allowed to retain a specified dollar value of certain assets in order to make a fresh start after bankruptcy. The amount of exempted assets allowed varies across states. We found that in those states with high exemptions, a significantly greater percentage of the sample fell in the highest income and asset category relative to the sample in the low exemption states. The implication is that the specification of the amount of assets that will be exempted in a straight bankruptcy serves as an admission threshold. Consumers with assets that exceed the amount that is exempted have less incentive to take bankruptcy, holding other things constant, than consumers who have all assets exempted in bankruptcy. Thus, the higher the threshold, the more attractive bankruptcy is to high-income consumers with considerable household and personal assets.

B. Stay on Collection Activity

Another facet of the law that may make bankruptcy attractive to consumers is the provision requiring the immediate cessation of collection activities. Almost 30 percent of the sample indicated that one of the reasons they filed bankruptcy was because "creditors tried to collect." Forty percent of the sample indicated that they filed to avoid paying a particular creditor. Those petitioners who could have repaid 75 percent or more of their debts were significantly more likely to cite that response than those petitioners who could have repaid less than 25 percent of their nonmortgage debts in 36 months. The implication is that some consumers taking bankruptcy are using the bankruptcy system to evade the collection efforts of creditors and avoid pay affordable debts. Limitation of collection activity after the petition is filed may have been one of the more significant features in terms of the effect of the law on the perceived benefits of personal bankruptcy.

This feature of the bankruptcy law has serious and far-reaching ramifications on the credit markets as they exist today. Credit, especially unsecured credit, is extended on the faith that the creditworthy consumers understands that he or she has a legally binding obligation to repay the full amount of the loan. By providing a legal method to uncouple the legally binding credit contract between the lender and borrower, the current bankruptcy law could be expected to increase the risk and therefore the cost of all unsecured credit.

IV. The Market's Response to the Bankruptcy Act

Changes in the ways that the market for consumer credit operates have already been made to reduce the expected benefits to consumers of taking bankruptcy as they are provided under the current law. Creditors who previously extended unsecured cash credit have drastically reduced the level of such activity. Secured credit such as second mortgage loans has been substituted for unsecured cash loans. Consumers with secured loans gain less from bankruptcy than consumers with unsecured loans, holding other things constant.

Creditors are being counseled to be more aggressive in challenging the documents of a bankruptcy case and to be more energetic in exercising the rights that they have with the existing law--an activity that will make bankruptcy more expensive for the consumer. In our sample we found that only 21 percent of petitioners had exemptions that protected all available assets. Thus, 79 percent of petitioners could expect to lose some assets by taking bankruptcy. A petitioner who anticipated a loss of assets would still have an incentive to take bankruptcy if the reduction in liabilities was greater than the expected loss of assets. However, we found that almost 13 percent of the sample had unsecured liabilities that were less than nonexempt assets. By taking bankruptcy, these petitioners realized no gain in wealth and actually suffered a reduction in wealth after lawyers' fees and loss of access to credit markets was accounted for.

Why would these consumers have declared bankruptcy? One hypothesis would be that creditors were not expected to exercise their rights to take nonexempt property to staisfy their claims or were not allowed to.

If that is the case, all petitioners realized a greater increase in wealth than shown in our analysis. If creditors do not insist on the enforcement of their rights to nonexempt assets, petitioners in bankruptcy basically have a larger amount of assets exempted than specified in the statute. This would make bankruptcy attractive for all consumers. Some creditors have made significant attacks on the problem of personal bankruptcy by demanding that closer attention be paid to the quality of information provided on the petition and by exercising their rights to collateral when they hold secured loans and to nonexempt assets when they hold unsecured loans. As a result, some creditors have experienced a reduction both in losses and in the incidence of petitioners choosing straight bankruptcy over a reorganization plan.

Another effective way to attack the problem of personal bankruptcy is suggested by the statistics concerning the petitioners' use of credit counseling. A concerted effort on the part of credit grantors toward the provision of low-cost, easily accessible, competent credit counseling services may provide a significant percentage of consumers who would otherwise take bankruptcy with an effective alternative to bankruptcy.

Finally, creditors are rapidly incorporating information that is predictive of bankruptcy into credit scoring models. The effect of these efforts will be a reduction in the amount of credit provided to high-risk applicants and perhaps a reduction in their need for debt relief. Industry studies of bankruptcy have found that credit reports of accounts that terminated with a bankruptcy showed a large number of credit sources being used and an increase in the number of credit inquiries shortly before the account went bankrupt. This is consistent with our findings. Petitioners for bankruptcy used credit from a large number of sources. Much of the credit was unsecured and obtained from sellers of goods and services rather than financial institutions.

The results presented in this monograph suggest that those who are developing credit scoring systems to identify potential bankruptcy may be wise to consider the effect of the costs and benefits of bankruptcy on a credit applicant's incentive to take bankruptcy. To make such an assessment, one would need fairly complete information about the applicant's assets and liabilities to estimate the net worth of the credit applicant. Obviously consumers with few assets, and great quantities of unsecured debts have much to gain by declaring bankruptcy. Converesely, those with a great amount of assets relative to liabilities have little to gain by declaring bankruptcy. It may be less costly to require more and better information on the financial conditions of loan applicants for credit scoring purposes than to try to discover characteristics that suggest the deterioration in moral fiber or the ulterior motives of the credit applicant.

V. Proposed Changes in Bankruptcy Legislation

One of the proposed changes in the bankruptcy law would restrict access to bankruptcy on the basis of the petitioners ability to repay debts out of anticipated income. Analysis presented in this monograph suggests that an admissions test to Chapter 7 would limit the use of Chapter 7 to those who are in the greatest need of relief from debts and have the least ability to repay their debts out of expected income. Those who would be denied Chapter 7, according to our data, had more education, higher income, and fewer dependents than those who would be admitted to Chapter 7. This may be a desirable outcome from a public policy point of view.

Other revisions in the laws relating to bankruptcy which would have a definite impact on the costs and benefits of bankruptcy should be considered. For example, a consumer may file for bankruptcy once every seven years, and keep a legally determined amount of assets required to make a fresh start. One might assume that individuals are entitled to exempt assets to make a fresh start because credit markets are closed to the consumer after bankruptcy. However, from our study, we know that that is not the case. Petitioners who had filed for bankruptcy before were able to obtain credit from many of the same sources as those petitioners who had not filed before. One would argue that : (a) consumers, like businesses, should not be entitled to exempted assets. Consumers still possess their human capital after bankruptcy and can borrow against it to buy the assets needed to start afresh; and (b) consumers should be allowed to petition for bankruptcy as often as they want. This may appear extreme at first glance but lenders would be more likely to limit the extension of credit to applicants who had filed for bankruptcy in the past if they knew that consumers could immediately file for bankruptcy again. In our sample, approximately ten percent of petitioners involved at least one repeater. Thus, this addition to the law would likely have a significant impact on the incidence of personal bankruptcy.

An alternative proposal for reducing the benefits of bankruptcy would be to reduce the value of assets exempted from bankruptcy. The high level of households and personal property that is exempted in many states enables consumers with great quantities of households' assets to file bankruptcy at a very low cost. One should question whether middle and upper income citizens really need this type of public assistance.

Personal bankruptcy is a fact of life. Whether it is an inalienable right was addressed in the first monograph of this series. How it is used, who uses it, its benefits and costs were examined in this monograph. Characteristics of the credit markets and problems with the implementation of the current law as well as specific provisions of the current law have been explored as factors contributing to the incidence of personal bankruptcy through their effect on the costs and benefits of bankruptcy. We provide these data with the hope that policy-makers and creditors can find the most cost-effective way to provide debt relief for those whose finances become truly unmanageable while maintaining the general integrity and enforceability of consumer credit contracts.

APPENDIX A

SELECTED BIBLIOGRAPHY

The references listed below have been selected from the computerized bibliography maintained on an on-going basis at the Credit Research Center. This represents only a partial listing of over 350 references concerning bankruptcy. The selection was based on the relevancy, currency, and apparent depth of the references. Obviously, there have been errors of inclusion and exclusion.

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APPENDIX B

PERSONAL INTERVIEW QUESTIONNAIRE

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033081
Draft 5

CREDIT STUDY

RESPONDENT'S NAME:____

ADDRESS:____

CITY/STATE:____

DATE:____________TIME STARTED:__________TIME ENDED:__________

INTERVIEWER:__________________LENGTH:______________(MINUTES)

Hello. My name is ____________________ of Opinion Research Corporation in Princeton, New Jersey. We have been requested by the Credit Research Center at Purdue University to conduct a nationwide survey on the subject of personal bankruptcy. As part of this survey, we are talking to people who have filed for bankruptcy so that we might better understand their attitudes and opinions. We are conducting this study with the full approval of the Court in which your case (is being) (was) heard. I want to stress that this survey is completely confidential, and that your answers will not be identified with you by name in any way.

A. Have you already had your hearing today or will you have it after this interview?	1 ALREADY HAD HEARING 2 WILL HAVE HEARING AFTER INTERVIEW

IDENTIFICATION NUMBERS

☐☐ DISTRICT ☐☐ LOCATION ☐☐☐☐☐ RESPONDENT'S PETITION #

JUDGE'S NAME:

____________________________________ ☐

(HAND EXHIBIT 1)

1a. On this card we've listed several factors that may or may not have led you to consider bankruptcy. Would you please read each item on the list, and tell me the number next to every factor that was important in your decision.

	IMPORTANT	MOST IMPORTANT
Personal Problems		
Medical bills (doctors, hospitals)	1	1
Marital problems (divorce, separation, alimony, child support)	2	2
Natural disasters (such as floods, hurricanes)	3	3
Death in the family	4	4
Addiction or dependency (drugs, alcohol, gambling)	5	5
Employment Problems		
Cutback in the number of hours worked	6	6
Laid off or fired from work	7	7
Your business failed	8	8
Business that employed you failed	9	9
Unable to work due to illness/accident	10	10
Lost second income	11	11
Credit/Financial Problems		
Bought too much on credit	12	12
Credit was too easy to get	13	13
Unable to get creditors to extend loans/ agree to different payment schedule	14	14
Creditors tried to collect their money	15	15
Sued by creditors	16	16
Wages actually garnished	17	17
Some property repossessed	18	18
Cosigned on a loan that wasn't paid	19	19
Cost of living went up	20	20
OTHER(S) (SPECIFY):		
______________________________	21	21
______________________________	22	22
	x y	x y

1b. Were there any other factors that led you to consider filing for bankruptcy? (RECORD ABOVE.)

IF MORE THAN ONE REASON GIVEN IN Qs.1a-b, ASK:

2. Of all the factors that led you to consider bankruptcy, which one or two were most important to you?

ASK QUESTION 3 FOR ITEM "a," THEN ASK QUESTIONS 4 AND 5. THEN REPEAT QUESTIONS 3 AND 4/5 FOR EACH OF THE OTHER ("b," "c," "d") ITEMS.

3. **Before** you filed for bankruptcy, had you heard about (READ ITEM)?

IF "YES," ON Q. 3, ASK:

4. Did you try ______________ before you filed for bankruptcy?

IF "NO," ON Q. 4, ASK:

5. Why didn't you try ____________________?

	HEARD OF		TRIED		WHY NOT
	YES	NO	YES	NO	
a. Credit counseling, where a counseler assists you in cutting back expenses and arranging partial payments	1 x	2 y	1 x	2 y	☐ x y
b. Debt consolidation loans, where you take out one loan to pay off all of your creditors and make only one monthly payment	1 x	2 y	1 x	2 y	☐ x y
c. Selling assets, such as property and possessions, to pay debts	1 x	2 y	1 x	2 y	☐ x y
d. Arranging different payment schedules with some or all of your creditors	1 x	2 y	1 x	2 y	☐ x y

6. Where did you get the idea to declare bankruptcy? Was it from someone in particular or was it something you read or heard about? (PROBE: From whom or where did you read/hear about it?)

1 READ ARTICLE OR BOOK
2 ADVERTISEMENT IN NEWSPAPER/MAGAZINE
3 ADVERTISEMENT ON RADIO/TELEVISION
4 LAWYER OR LEGAL AID SERVICE
5 FRIEND/RELATIVE/COWORKER
6 CREDIT COUNSELING SERVICE
7 EMPLOYER
8 OWN IDEA/GENERAL KNOWLEDGE/JUST KNEW
9 OTHER (SPECIFY): ______________________________
x y

7. Did you use a lawyer to help you file for bankruptcy?

1 YES
2 NO → SKIP TO Q. 9
x y

IF USED A LAWYER ("1" ON Q. 7), ASK:

8. How did you select your lawyer?

1 HE IS FAMILY LAWYER/USED HIM BEFORE
2 REFERRED BY ANOTHER LAWYER
3 ADVERTISEMENT
4 RECOMMENDED BY FRIEND/RELATIVE/COWORKER
5 FROM THE PHONE BOOK
6 OTHER (SPECIFY): ______________________
____
____

x y

9. Instead of the process you are using, there is an alternative legal process. Under that process you could have repaid all or some of your debts over a period of a few years, while still being protected from your creditors. When you were thinking about filing for bankruptcy, did you hear about this process?

1 YES
2 NO → SKIP TO Q. 12
x y

IF "YES" ("1" ON Q. 9), ASK:

10. What was this process called?

1 CHAPTER 13
2 OTHER (SPECIFY): ______________________
3 DON'T KNOW ______________________
x y

11. Why did you decide not to use this process? (DO NOT READ LIST. PROBE: Were there any other reasons?)

1 ATTORNEY ADVISED AGAINST IT
2 SPOUSE/FRIENDS ADVISED AGAINST IT
3 NOT ENOUGH INCOME/DEBTS TOO HIGH/WOULD HAVE TAKEN TOO LONG
4 TO AVOID PAYING CERTAIN CREDITORS
5 NO PARTICULAR REASON
6 OTHER (SPECIFY): ______________________
____
x y

(HAND EXHIBIT 2)

12. Here is a list of actions which creditors might take against someone who has not met their debt obligation. Would you please read the list and tell me the number of every action taken against you by any of your creditors.

	CREDITORS DID	IMPORTANT
Threaten to repossess your personal property	1	1
Actually repossess your personal property	2	2
Seek to collect an unpaid balance after having repossessed some property	3	3
Threaten to foreclose on your home	4	4
Actually foreclose on your home	5	5
Threaten to garnish your wages	6	6
Actually garnish your wages	7	7
Telephone you frequently at home or work	8	8
Come to see you at home or work	9	9
Send you threatening letters	10	10
Contact a cosigner on a loan	11	11
Contact your employer	12	12
Contact a relative	13	13
OTHER (SPECIFY): ________	14	14
NO ACTIONS TAKEN/NONE IMPORTANT	15	15
	x y	x y

IF "YES" TO ANY STATEMENT ABOVE ("1" THRU "12"), ASK:

13. Which of these actions by your creditors were important in your decision to declare bankruptcy?

14a. In talking with other people who have declared bankruptcy we have found some who told us that one of the reasons they declared bankruptcy was not so much to cancel all their debts as it was to avoid one or more specific creditors. Would you say that this situation applies to you?

1 YES
2 NO → SKIP TO Q. 15
x y

IF "YES," ASK:

14b. Which creditors didn't you want to pay? (DO NOT READ LIST. CIRCLE ALL THAT APPLY.)

1 BANK
2 SAVINGS & LOAN/MORTGAGE CO.
3 CREDIT UNION
4 FINANCE OR LOAN COMPANY
5 RETAILER/DEALER/CONTRACTOR
6 FRIEND/RELATIVE/COWORKER
7 DOCTOR/HOSPITAL
8 OTHER (SPECIFY): ________
____
x y

14c. What is the total amount that you owe this (those) creditor(s)? (IF DON'T KNOW EXACT AMOUNT, ASK FOR BEST ESTIMATE.)

$ ________
0 DON'T KNOW
x y

15. In the six months or so before you filed for bankruptcy, did you make any of the following purchases on credit? (READ LIST)

1 House or mobile home
2 Car o
3 Recreational vehicle or motorcycle
4 Home appliance or furniture costing over $200 per item
5 Jewelry, watch or fur costing over $200 per item
6 Vacation airfare, lodging or meals
7 Investment land or property
8 School tuition
9 NONE OF THESE
x y

15a. Did you use over $200 in credit either to get a cash loan or to make other purchases during the past six months? (IF "YES," ASK: What was it for?)

1 YES (SPECIFY): ____________________
____
2 NO
x y

(HAND EXHIBIT 3)

16. Which of the assets on the list do you plan to keep through provisions of the law, that is, exemptions, that permit you to keep items up to some dollar value? Just read me the numbers, please.

	Exemptions	Reaffirmation
Financial assets	1	1
House or mobile home	2	2
Car	3	3
Truck	4	4
Recreational vehicle or motorcycle	5	5
Furniture or appliances	6	6
Jewelry, watch or furs	7	7
Clothing	8	8
Land or investment property	9	9
Any others? (SPECIFY): ____________________	10	10
NONE	11	11
DON'T KNOW	12	12
	x y	x y

17. And which do you plan to keep by agreeing to make payments after bankruptcy is final, sometimes called reaffirmation of the debt? ____________________

18. Are there any other creditors you plan to repay? (IF "YES, ASK: Which type of creditors?)

1 NO/NONE
2 BANK
3 SAVINGS & LOAN/MORTGAGE CO.
4 CREDIT UNION
5 FINANCE OR LOAN CO.
6 RETAILER/DEALER/CONTRACTOR
7 RELATIVE/FRIEND/COWORKER
8 DOCTOR/HOSPITAL
9 OTHER (SPECIFY): ____________________
____
x y

19. Which of the assets on this list do you expect to lose by filing for bankruptcy? Just read me the numbers please.

1 Financial assets

2 House or mobile home
3 Car
4 Truck
5 Recreational vehicle or motorcycle
6 Furniture or appliances
7 Jewelry, watch or furs
8 Clothing
9 Land or investment property
10 Any others? (SPECIFY):________

11 NONE
12 DON'T KNOW
x y

IF FINANCIAL ASSETS LOST ("1" ON Q. 19),

20. Now, just think about the financial assests you expect to lose, that is, any bank accounts, stocks, bonds, or other financial investments. About how much money do you estimate you will lose? (IF NOT SURE, ASK FOR BEST ESTIMATE.)

$________
0 DON'T KNOW
x y

IF ANY TYPE OF ASSETS LOST OTHER THAN FINANCIAL ("2-10" ON Q. 19), ASK:

21. Now, think just about personal property you expect to lose, that is, such things as (NAME ITEMS 2-10 CIRCLED in Q. 19). About how much do you think you could get for these goods if you sold them, rather than lost them through bankruptcy? (IF NOT SURE, ASK FOR BEST ESTIMATE.)

$________
0 DON'T KNOW
x y

22. Compared to your credit situation before you filed for bankruptcy, do you think it will be more difficult or less difficult for you to get credit in the future from each of the following types of creditors?

	MORE DIFFICULT	LESS DIFFICULT	NO CHANGE/ SAME AS BEFORE	DON'T KNOW
Bank	1	2	3	4
Savings & Loan or Mortgage Company	1	2	3	4
Credit Union	1	2	3	4
Finance or Loan Company	1	2	3	4
Retailer, Dealer, or Contractor	1	2	3	4
Friends, Family, or Coworkers	1	2	3	4
Doctor or Hospital	1	2	3	4
Other (Specify):________	1	2	3	4
________	1	2	3	4

23. How did you learn about getting credit in the future? Who or what was your source of information?

1 READ ARTICLE OR BOOK
2 ADVERTISEMENT IN NEWSPAPER/MAGAZINE
3 ADVERTISEMENT ON RADIO/TELEVISION
4 LAWYER OR LEGAL AID SERVICE
5 FRIEND/RELATIVE/COWORKER
6 CREDIT COUNSELING SERVICE
7 OWN IDEA/GENERAL KNOWLEDGE/JUST KNEW
8 OTHER (SPECIFY):________
x y

24. As you probably know, there are credit bureaus which keep track of people's credit experience. Do you think their credit report will show a record of your bankruptcy?

1 YES
2 NO
3 DON'T KNOW
x y

SKIP TO Q. 26

IF YES ("1" ON Q. 24), ASK:

25. For how many years will a record of your bankruptcy be on your credit record?

________ YEARS
0 DON'T KNOW
x y

26. Do you know whether or not it would be legal for you to ever file for bankruptcy again?

1 YES
2 NO
3 DON'T KNOW
x y

SKIP TO Q. 29

IF YES ("1" ON Q. 26), ASK:

27. How many years from now could you file for bankruptcy again?

________ YEARS
0 DON'T KNOW
x y

28. Would you ever again consider bankruptcy as a solution to your financial problems?

1 YES
2 NO
3 DON'T EXPECT ANY MORE PROBLEMS
4 DON'T INTEND TO LET THIS HAPPEN AGAIN
x y

(HAND EXHIBIT 4)

29. Which number in the first category on this card best describes your current marital status?

1 MARRIED
2 SEPARATED
3 DIVORCED
4 LIVING AS MARRIED
5 SINGLE-NEVER MARRIED
6 WIDOWED
x y

3–6 → SKIP TO Q. 32

IF "1" OR "2" ON Q. 29, ASK:

30. Did you file for bankruptcy for yourself individually, or did you file jointly with your spouse?

1 INDIVIDUALLY
2 JOINTLY → SKIP TO Q. 32
x y

IF FILED "INDIVIDUALLY," ASK:

31a. Did your spouse also file for bankruptcy on (his)(her) own?

1 YES
2 NO → SKIP TO Q. 32
x y

IF "YES," ASK:

31b. Why did (he)(she) file for bankruptcy separately rather than ~~with you~~ in a joint petition?

☐
x y

31c. When and where did (he)(she) file for bankruptcy? (IF DON'T KNOW EXACT DATE, PROBE FOR YEAR AND APPROXIMATE MONTH)

DATE:__________ MONTH:__________ YEAR:________

CITY:________________ STATE:__________

0 DON'T KNOW x y

32. Have you (or your [former] spouse) ever filed for bankruptcy before? (PROBE: Was it you, your spouse, or both of you jointly?)

1 NEVER FILED BEFORE
2 RESPONDENT FILED INDIVIDUALLY
3 SPOUSE FILED INDIVIDUALLY
4 FILED JOINTLY
5 RESPONDENT FILED JOINTLY WITH FORMER SPOUSE
6 SPOUSE FILED JOINTLY WITH FORMER SPOUSE
x y

IF "MARRIED" OR "SEPARTED" ("1" OR "2" ON Q. 29), ASK QUESTIONS 33-38 FOR BOTH HUSBAND AND WIFE. ALL OTHERS, ASK EACH QUESTION JUST FOR RESPONDENT. RECORD RESPONSES BY SEX.

(HAND EXHIBIT 4)

33. Which number in the middle category on this card contains your (your spouse's) age? Just read me the number, please.

	MALE	FEMALE
Under 25	1	1
25-34	2	2
35-44	3	3
45-54	4	4
65 or older	5	5
	x y	x y

34. And which number in the last category of this card describes the level of schooling that you (your spouse) completed?

	MALE	FEMALE
Did not finish High school	1	1
High school graduate	2	2
Training or vocational school	3	3
Attended college courses	4	4
College graduate	5	5
Advanced college degree	6	6
	x y	x y

35. Are you (Is your spouse) now employed, either full- or part-time?

	MALE	FEMALE
Employed Full-Time	1	1
Employed Part-Time	2	2
Not Employed	3	3
	x y	x y

IF RESPONDENT (OR SPOUSE) EMPLOYED, ASK:

35a. What type of work do you (does your spouse) do?

MALE: ______________________________ x y ☐

FEMALE: ______________________________ x y ☐

35b. Do you (Does your spouse) have a second job?

MALE:	1 YES	2 NO	x	y
FEMALE:	1 YES	2 NO	x	y

IF RESPONDENT (OR SPOUSE) NOT EMPLOYED, ASK:

(HAND EXHIBIT 5)

36. Which of the reasons listed on this card describes why you aren't (your spouse isn't) working? Just read me the number.

	MALE	FEMALE
Student	1	1
Retired	2	2
Permanently disabled	3	3
Homemaker/care of children	4	4
Laid off/unable to find work	5	5
On strike	6	6
On sick leave	7	7
My business failed	8	8
Employer's business failed	9	9
OTHER REASON (SPECIFY):	0	0
______________________		
______________________	x y	x y

37. How many months out of the past 12 have you (has your spouse) been employed, either full- or part-time?

	MALE	FEMALE
# OF MONTHS:	____	____
	x y	x y

38. Are you (Is your spouse) a member of a credit union?

	MALE	FEMALE
YES	1	1
NO	2	2
	x y	x y

39. How many people, including yourself and any others, are dependent on you for their principal means of support? This is the number of exemptions you report on your Federal income tax form.

OF DEPENDENTS: ______________ x y

IF MORE THAN JUST RESPONDENT, ASK:

39a. Which of the following are dependent on you for their principal means of support?

1 Spouse
2 Children under 6 years of age (Specify how many:__________)
3 Children age 6-12 (Specify how many:__________)
4 Children age 13-17 (Specify how many:__________)
5 Children over age 17 (Specify how many:__________)
6 Parent (Specify how many:__________)
7 Other (Specify relationship__________and number:__________)
x y

40. Do you own or rent the dwelling in which you live?

1 OWN → SKIP TO Q. 42
2 RENT
3 NEITHER (LIVE WITH PARENT/ OTHER RENT-FREE) → SKIP TO Q. 43

IF "RENT," ASK:

41. How much do you pay in rent per month?

$ ____________ x y

41a. Does your monthly rent include some or all of your utilities, that is, electricity, gas, oil, water, and telephone?

1 ALL UTILITIES INCLUDED → SKIP TO Q. 43
2 SOME UTILITIES INCLUDED
3 NO UTILITIES INCLUDED
x y

IF "SOME/NO UTILITIES INCLUDED", ASK:

41b. Over and above what is included in your rent payment, about how much do you pay directly for utilities per month? (IF NOT SURE, ASK FOR BEST ESTIMATE. IF CAN'T SPECIFY PER MONTH, ASK FOR BEST ESTIMATE OF TOTAL COST FOR LAST YEAR.)

$ ____________ PER MONTH
OR
$ ____________ LAST YEAR

0 DON'T KNOW
x y

→ SKIP TO Q. 43

IF "OWN" (#1" ON Q. 40), ASK:

42. What is your total monthly mortgage payment? (IF NOT SURE, ASK FOR BEST ESTIMATE)

$ ____________ x y

42a. Does your monthly mortgage payment include your . . .?

	INCLUDE YES	INCLUDE NO		DON'T KNOW		
a. Property tax	1	2	$ ________ PER YEAR	0	x	y
b. Homeowner's insurance	1	2	$ ________ PER YEAR	0	x	y
c. All utilities, that is, electricity, gas, oil, water, & telephone	1	2	$ ________ PER MONTH OR $ ________ LAST YEAR	0	x	y

FOR EACH ITEM NOT INCLUDED IN MORTGAGE, ASK:

42b. About how much do you pay . . .?

(a) Per year for property tax?
(b) Per year for homeowner's insurance?
(c) Per month for any utilities not included in your mortgage?
(IF NOT SURE, ASK FOR BEST ESTIMATE. IF CAN'T GIVE MONTHLY COST, ASK FOR BEST ESTIMATE OF TOTAL COST FOR LAST YEAR.)

43. Which, if any, of the following expenses do you usually have each month?

MONTHLY EXPENSES		AVERAGE MONTHLY PAYMENT	DON'T KNOW		
Alimony	1	$	0	x	y
Child support	2	$	0	x	y
Child care because you (or your spouse) work	3	$	0	x	y
Regular treatment of a long-term or chronic ailment	4	$	0	x	y
Life or medical insurance	5	$	0	x	y
Any other regular monthly payments (SPECIFY):			0	x	y
______________	6	$______________	0	x	y
______________	7	$______________	0	x	y
______________	8	$______________	0	x	y
NONE	9 → SKIP TO Q. 45a				

FOR EACH MONTHLY EXPENSE, ASK:

44. What is your average monthly payment for ______________?

45a. Have you received any food stamps in the past month?

1 YES

2 NO → SKIP TO Q. 46

x y

IF "YES", ASK:

45b. What was the total value of the food stamps you received last month?

$______________

0 DON'T KNOW

x y

46. How much was your family's total income last month from nontaxable sources, such as social security, child support payments, unemployment or workmen's compensation, and welfare? (IF RESPONDENT IS NOT SURE, ASK FOR BEST ESTIMATE.)

$______________

0 NONE

9 DON'T KNOW

x y

47. And, how much was your total family income before taxes from all taxable sources last month? (IF RESPONDENT IS NOT SURE, ASK FOR BEST ESTIMATE.)

$______________

0 NONE

9 DON'T KNOW

x y

48. By December of this year, how likely is it that your total monthly income from all sources will be higher or lower than it was last month? Would you say that it will definitely be higher, probably be higher, probably be lower, definitely be lower, or will it be about the same?	1 DEFINITELY HIGHER 2 PROBABLY HIGHER 3 PROBABLY LOWER 4 DEFINITELY LOWER 5 ABOUT THE SAME 6 DON'T KNOW x y
IF "HIGHER" OR "LOWER" ON Q. 48, ASK: 49. Do you expect that (increase) (decrease) will be 10% or less or will it be over 10%?	1 10% OR LESS 2 OVER 10% 3 DON'T KNOW x y

INTERVIEWER: HAND THE CREDIT REPORT RELEASE FORM TO RESPONDENT(S) AND ASK HIM/HER/THEM TO READ IT AND THEN TO FILL IN THE REQUESTED INFORMATION AND SIGN HIS/HER/THEIR NAME(S).

Thank you very much for your time and cooperation.

RECORD THE FOLLOWING:

RESPONDENT'S SEX: 1 MALE 2 FEMALE

RESPONDENT'S RACE: 1 WHITE 2 BLACK 3 HISPANIC 4 OTHER

WILL RELEASE CREDIT REPORT: 1 YES 2 NO x y

ATTORNEY ATTENDED THE INTERVIEW: 1 YES 2 NO

INTERVIEWER: ON A SCALE OF "1" to "5", HOW WOULD YOU DESCRIBE HOW OPEN AND COOPERATIVE THIS RESPONDENT WAS DURING THE INTERVIEW?

VERY OPEN/ VERY COOPERATIVE	1	2	3	4	5	NOT AT ALL OPEN/ VERY UNCOOPERATIVE

INTERVIEWER: ATTACH RESPONDENT'S CREDIT REPORT RELEASE FORM AND A COPY OF HIS/HER BANKRUPTCY PETITION (WHICH YOU MUST OBTAIN FROM THE CLERK OR XEROX) TO THIS QUESTIONNAIRE.

EXHIBIT 1

Personal Problems

1 Medical bills (doctors, hospitals)
2 Marital problems (divorce, separation, alimony, child support)
3 Natural disasters (such as floods, hurricanes)
4 Death in the family
5 Addiction or dependency (drugs, alcohol, gambling)

Employment Problems

6 Cutback in the number of hours worked
7 Laid off or fired from work
8 Your business failed
9 Business that employed you failed
10 Unable to work due to illness/accident
11 Lost second income

Credit/Financial Problems

12 Bought too much on credit
13 Credit was too easy to get
14 Unable to get creditors to extend loans/ agree to different payment schedule
15 Creditors tried to collect their money
16 Sued by creditors
17 Wages actually garnished
18 Some property repossessed
19 Cosigned on a loan that wasn't paid
20 Cost of living went up
21 Anything else? (PLEASE SPECIFY)

EXHIBIT 2

1 Threaten to repossess your personal property

2 Actually repossess your personal property

3 Seek to collect an unpaid balance after having repossessed some property

4 Threaten to foreclose on your home

5 Actually foreclose on your home

6 Threaten to garnish your wages

7 Actually garnish your wages

8 Telephone you frequently at home or work

9 Come to see you at home or work

10 Send you threatening letters

11 Contact a cosigner on a loan

12 Contact your employer

13 Contact a relative

14 Anything else? (PLEASE SPECIFY)

EXHIBIT 3

1. Financial assets (bank accounts, stocks, bonds, CD's)
2. House or mobile home
3. Car
4. Truck
5. Recreational vehicle or motorcycle
6. Furniture or appliances
7. Jewelry, watch, or furs
8. Clothing
9. Land or investment property
10. Any Others? (PLEASE SPECIFY)

EXHIBIT 4

MARITAL STATUS	1	MARRIED
	2	SEPARATED
	3	DIVORCED
	4	LIVING AS MARRIED
	5	SINGLE-NEVER MARRIED
	6	WIDOWED
AGE	1	Under 25
	2	25-34
	3	35-44
	4	45-54
	5	55-64
	6	65 or older
EDUCATION	1	Did not finish high school
	2	High school graduate
	3	Training or vocational school
	4	Attended college courses
	5	College graduate
	6	Advanced college degree

EXHIBIT 5

1 Student
2 Retired
3 Permanently disabled
4 Homemaker/care of children
5 Laid off/unable to find work
6 On strike
7 On sick leave
8 My business failed
9 Employer's business failed
10 OTHER (PLEASE SPECIFY)

AUTHORIZATION FOR CREDIT REPORT

I/We, the undersigned, have voluntarily participated in an interview as part of a study of personal bankruptcy conducted by the Credit Research Center of Purdue University.

By signing this paper, I/we authorize the credit reporting agency (credit bureau) in my/our area to provide the Credit Research Center with my/our credit report(s) applicable to the time of my/our filing for bankruptcy.

This authorization is for the sole purpose of the bankruptcy study. My/Our understanding is that our name and address will be removed from the credit report and any data used in the study will be treated anonymously.

PLEASE PRINT:

YOUR FULL NAME:____

YOUR SOCIAL SECURITY NUMBER: ______________________________

IF MARRIED:

YOUR SPOUSE'S NAME:______________________________________

YOUR SPOUSE'S SOCIAL SECURITY NUMBER:________________________

ADDRESS:____

CITY:____________________STATE:___________ZIP CODE:______

IF YOU HAVE LIVED AT THE ABOVE ADDRESS LESS THAN ONE YEAR, PLEASE FILL IN YOUR FORMER ADDRESS:

FORMER ADDRESS:____

CITY:____________________STATE:___________ZIP CODE:______

PLEASE SIGN:

YOUR SIGNATURE:____

SPOUSE'S SIGNATURE:_____________________________________

DATE:____

APPENDIX C

DATA RECORDED FROM CHAPTER 7 PETITION

33852

CREDIT STUDY

PETITION DATA SHEET

1 Petition Data of Debtor Interviewed **Before** Hearing
2 Petition Data of Debtor Interviewed **After** Hearing
→ Yellow Form

3 Petition Data of Debtor Who Refused Interview
→ Blue Form

COVER SHEET(S)

1. Respondent's Petition # (use last 5 numbers): __ __ __ __ __
(Also called bankruptcy, docket, file, proceeding, or case number)

2. Debtor (petitioner) is: 1 Individual 2 Husband/wife jointly

(Cover sheet may indicate "Individual" or "Joint" Petition or there will be boxes next to the words "individual" and "husband and wife as joint individuals" and the appropriate one will be checked to indicate an individual or joint petition)

3. Debtor's name and social security number (include both parties if joint petition):

Male: ______________________ Social Security #: ______________

Female: ______________________ Social Security #: ______________

4. Zip Code (of most recent address): __ __ __ __ __ __

5. Date filed (or executed on): ____/____/____
(Stamped or written in) Month Date Year

STATEMENT PURSUANT TO RULE 219b OR DISCLOSURE OF COMPENSATION PAID OR PROMISED TO ATTORNEY

6. Legal services used: 1 Yes 2 No

(No "Rule 219b Statement" attached to petition implies no legal services used. Circle "2" and go on to #7.)

If Legal Services Used:

a. Total fee (paid and promised/due): $ ______________ 0 NR

b. Attorney's Name: ______________________

Address:

______________________ ______________________

STATEMENT OF FINANCIAL AFFAIRS

7. Specify which form used (heading across top of page or top right corner)

1 Statement of Financial Affairs for Debtor Not Engaged in Business → SKIP TO #12

2 Statement of Financial Affairs For Debtor Engaged in Business → GO TO #8

Debtor Engaged In Business ("2" circled on #7)

8. Prior bankruptcy
(probably item #7)
1 One or more prior bankruptcies listed
2 No other bankruptcies listed

9. Suits, executions, and attachments
(probably item 12)

Property attached, garnished, or seized (probably "c" in this section)	1 Yes	2 No	3 NR

10. Transfer of property
(probably item 14)

(1) Made one or more unusual gifts in year prior to bankruptcy (probably "a" in this section)	1 Yes	2 No	3 NR
(2) Made other transfer(s) (probably "b" in this section)	1 Yes	2 No	3 NR

11. Repossessions and returns
(probably item #13)

Any property returned to/repossessed by seller during year preceding bankruptcy	1 Yes	2 No	3 NR

→ SKIP TO #17

Debtor Not Engaged In Business ("1" Circled On #7)

12. Occupation and Income
(Probably item #2)

RECORD HERE ALSO IF JOINT PETITION AND AMOUNTS SPECIFIED FOR BOTH PARTIES

		Total	Male	Female
(1) Income from trade and profession (probably "d" in this Section)				
	1980	\$______ 0 None X NR	\$______ 0 None X NR	\$______ 0 None X NR
	1979	\$______ 0 None X NR	\$______ 0 None X NR	\$______ 0 None X NR
(2) Income from other sources (probably "e" in this Section)				
	1980	\$______ 0 None X NR	\$______ 0 None X NR	\$______ 0 None X NR
	1979	\$______ 0 None X NR	\$______ 0 None X NR	\$______ 0 None X NR

13. Prior bankruptcy
(probably item #7)
1 One or more prior bankruptcies listed
2 No other bankruptcies listed

14. Suits, executions, and attachments
(probably item #10)
Property attached, garnished, or seized (probably "c" in this section) 1 Yes 2 No 3 NR

15. Transfer of property
(probably item #12)
(1) Made one or more unusual gifts in year prior to bankruptcy (probably "a" in this section) 1 Yes 2 No 3 NR
(2) Made other transfer(s) (probably "b" in this section) 1 Yes 2 No 3 NR

16. Repossessions and returns
(probably item #13)
Any property returned to/repossessed by seller during year [illegible] 1 Yes 2 No 3 NR

→ GO ON TO #17

SCHEDULE A-2 CREDITORS HOLDING SECURITY

(Schedule A-2 is sometimes listed as a separate section or page. If so, include the requested information for all items in this section. Add up the "Market Value" and the "Amount of Claim" of all items listed (if no "totals" are shown) and record each of these totals in the spaces below.

If Schedules A-2 and A-3 are listed together, include below only those items checked as "secured." Include the totals only for the secured items.)

17. Total market value of all (secured) items listed $__________

18. Total claims of all (secured) items listed $__________

19. FOR EACH ITEM/TYPE OF SECURITY LISTED IN SCHEDULE A-2, SPECIFY:

	ITEM/TYPE OF SECURITY	WHEN INCURRED MONTH/YEAR	MARKET VALUE	AMOUNT OF CLAIM
1	House (1st/only mortgage)* 0 No house listed	___/___ 0 NR	$_____ 0 NR	$_____ 0 NR
2	Same house (2nd mortgage) 0 No second mortgage	_____ 0 NR	$_____ 0 NR	$_____ 0 NR

FOR ALL OTHER ITEMS LISTED IN SCHEDULE A-2, FILL IN GENERAL DESCRIPTION (E.G., CAR, BOAT, FURNITURE) IN THE SPACE BELOW AND COMPLETE THE REST OF THE INFORMATION:

3	__________	___/___ 0 NR	$_____ 0 NR	$_____ 0 NR
4	__________	___/___ 0 NR	$_____ 0 NR	$_____ 0 NR
5	__________	___/___ 0 NR	$_____ 0 NR	$_____ 0 NR
6	__________	___/___ 0 NR	$_____ 0 NR	$_____ 0 NR
7	__________	___/___ 0 NR	$_____ 0 NR	$_____ 0 NR
8	__________	___/___ 0 NR	$_____ 0 NR	$_____ 0 NR
9	__________	___/___ 0 NR	$_____ 0 NR	$_____ 0 NR

*If there is more than one mortgage (creditor and claim) on the same house and no distinction [illegible] first or second mortgage, assume [illegible] mortgage is the older (earlier date on when incurred) one. If no dates are given, assume that the larger amount is the "first" mortgage.

#19 (Continued) Schedule A-2

ITEM/TYPE OF SECURITY		WHEN INCURRED	MARKET VALUE	AMOUNT OF CLAIM
10	______	___/___ 0 NR	$___ 0 NR	$___ 0 NR
11	______	___/___ 0 NR	$___ 0 NR	$___ 0 NR
12	______	___/___ 0 NR	$___ 0 NR	$___ 0 NR
13	______	___/___ 0 NR	$___ 0 NR	$___ 0 NR
14	______	___/___ 0 NR	$___ 0 NR	$___ 0 NR
15	______	___/___ 0 NR	$___ 0 NR	$___ 0 NR
16	______	___/___ 0 NR	$___ 0 NR	$___ 0 NR
17	______	___/___ 0 NR	$___ 0 NR	$___ 0 NR
18	______	___/___ 0 NR	$___ 0 NR	$___ 0 NR
19	______	___/___ 0 NR	$___ 0 NR	$___ 0 NR
20	______	___/___ 0 NR	$___ 0 NR	$___ 0 NR
21	______	___/___ 0 NR	$___ 0 NR	$___ 0 NR
22	______	___/___ 0 NR	$___ 0 NR	$___ 0 NR
23	______	___/___ 0 NR	$___ 0 NR	$___ 0 NR
24	______	___/___ 0 NR	$___ 0 NR	$___ 0 NR
25	______	___/___ 0 NR	$___ 0 NR	$___ 0 NR
26	______	___/___ 0 NR	$___ 0 NR	$___ 0 NR

SCHEDULE A-3 CREDITORS HAVING UNSECURED CLAIMS WITHOUT PRIORITY

(If Schedule A-3 is listed as a separate section or page, include the requested **information** for all items included in this section. Add up the "Amount of Claim" **of all** items listed (if no "total" is shown) and record the total in the space **below.** (Note: Page may be called "Listing of Creditors.")

If Schedule A-3 is listed with Schedule A-2, include below only those items checked **as** "unsecured." Include the total only for the unsecured items.

20. Total claims of all (unsecured) items listed $ ________________

CREDITOR CODES:

1 Bank
2 Savings & Loan or Mortgage Company
3 Credit Union
4 Finance or Loan Company
5 Retailer (Store)
6 Dealer or Contractor
7 Doctor or Hospital
8 Friend or Relative or Co-worker
9 Other/Not Sure of Type (SPECIFY NAME IN SPACE)

21. FOR EACH CREDITOR LISTED IN SCHEDULE A-3, CIRCLE APPROPRIATE CREDITOR CODE AND FILL IN AMOUNT OF CLAIM

CREDITOR CODE	AMOUNT OF CLAIM
#1 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW) ________________	$ ________________
#2 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW) ________________	$ ________________
#3 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW) ________________	$ ________________
#4 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW) ________________	$ ________________
#5 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW) ________________	$ ________________
#6 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW) ________________	$ ________________
#7 1 2 3 4 5 6 7 8 9 (SPECIFY BELOW) ________________	$ ________________

#21 (Continued) Schedule A-3

	CREDITOR CODE	AMOUNT OF CLAIM
#8	1 2 3 4 5 6 7 8 9 (SPECIFY BELOW) __________	$ __________
#9	1 2 3 4 5 6 7 8 9 (SPECIFY BELOW) __________	$ __________
#10	1 2 3 4 5 6 7 8 9 (SPECIFY BELOW) __________	$ __________
#11	1 2 3 4 5 6 7 8 9 (SPECIFY BELOW) __________	$ __________
#12	1 2 3 4 5 6 7 8 9 (SPECIFY BELOW) __________	$ __________
#13	1 2 3 4 5 6 7 8 9 (SPECIFY BELOW) __________	$ __________
#14	1 2 3 4 5 6 7 8 9 (SPECIFY BELOW) __________	$ __________
#15	1 2 3 4 5 6 7 8 9 (SPECIFY BELOW) __________	$ __________
#16	1 2 3 4 5 6 7 8 9 (SPECIFY BELOW) __________	$ __________
#17	1 2 3 4 5 6 7 8 9 (SPECIFY BELOW) __________	$ __________
#18	1 2 3 4 5 6 7 8 9 (SPECIFY BELOW) __________	$ __________

SCHEDULE B-1 REAL PROPERTY

22. Market value of each house listed:

$ ________________ $ ________________ $ ________________

0 No house(s) listed

EXEMPTION ELECTION (Located Between Schedules B-3 and B-4)

23. The debtor(s) elects to . . . exempt(ions) pursuant to
(Circle item(s) checked)

1 Federal Exemption 11 U.S.C. 522 3 Both
2 State Exemption (laws of the State ________________) 4 NR

SCHEDULE B-4 PROPERTY CLAIMED AS EXEMPT

24. Value claimed exempt -- total $ ________________
(If no total amount is shown, add up the value claimed exempt for each item listed in B-4) 0 NONE X NR

SUMMARY OF DEBTS AND PROPERTY

25. A-2 Secured claims $ ________________ 0 NONE

26. A-3 Unsecured claims without priority $ ________________ 0 NONE

27. Schedule A Total $ ________________ 0 NONE

28. B-1 Real property (total value) $ ________________ 0 NONE

29. Schedule B Total $ ________________ 0 NONE

30. Does Schedule B Total include item listings for B-1, B-2, B-3 and B-4 or isn't the B-4 item included in (above) the Schedule B Total line?
1 B-4 Is included in total
2 B-4 Is not included

PUBLICATIONS
CREDIT RESEARCH CENTER

MONOGRAPH No. 1: An Empirical Analysis of Retail Revolving Credit
MONOGRAPH No. 2: Credit Policies and Store Locations in Arkansas Border Cities: Merchant Reactions to a Ten Percent Finance Charge Ceiling
MONOGRAPH No. 3: Research Topics in Mortgage Markets: Proceedings of a Seminar
MONOGRAPH No. 4: An Economic Report on Consumer Lending in Texas
MONOGRAPH No. 5: Mortgage Banking 1963 to 1972: A Financial Intermediary in Transition
MONOGRAPH No. 6: A Thesaurus of Terms in Mortgage and Consumer Credit
MONOGRAPH No. 7: A Bibliography of Consumer Financial Services and Regulation
MONOGRAPH No. 8: A Compilation of Federal and State Laws Regulating Consumer Financial Services
MONOGRAPH No. 10: The Impact of Regulation on the Provision of Consumer Financial Services by Depository Institutions: Research Backgrounds and Needs
MONOGRAPH No. 12: Cost/Benefit Analysis of Creditors' Remedies
MONOGRAPH No. 13: Consumer Perception of Credit Insurance on Retail Purchases
MONOGRAPH No. 14: An Economic Analysis of the "Due On Sale" Clause in the California Mortgage Market
MONOGRAPH No. 15: Credit Unions: CRC 1979 Creditors Survey
MONOGRAPH No. 16: Savings and Loan Associations: CRC 1979 Creditors Survey
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MONOGRAPH No. 21: Consumer Financial Data Sources
MONOGRAPH No. 22: CRC 1979 Consumer Financial Survey
MONOGRAPH No. 23: Consumer Bankruptcy Study, Volume 1, Consumers' Right to Bankruptcy Origins and Effects
MONOGRAPH No. 24: Personal Bankruptcy: Causes, Costs and Benefits, Volume II
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WORKING PAPER No. 2: EFTS and Consumer Credit (Revised)
WORKING PAPER No. 3: The Impact of General Credit Restraint on Consumer Instalment Credit Flows
WORKING PAPER No. 4: The Effect of Alternative Billing Methods Upon Retail Revolving Credit Yields
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WORKING PAPER No. 8: Discrimination on the Basis of Sex Under the Equal Credit Opportunity Act
WORKING PAPER No. 9: Competition Between Banks and Finance Companies: A Cross Section Study of Personal Loan Debtors
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WORKING PAPER No. 14: Creditor Remedy Restrictions and Interstate Differences in Personal Loan Rates and Availability: A Supplementary Analysis
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WORKING PAPER No. 18: Problems in Applying Discriminant Analysis in Credit Scoring Models
WORKING PAPER No. 19: Testing for Sex Discrimination in Commercial Bank Consumer Lending
WORKING PAPER No. 20: Banks' Lending Response to Restricted Creditor Remedies
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WORKING PAPER No. 36: Evidence of the Effect of Restrictive Loan Rate Ceilings on Prices of Consumer Financial Services
WORKING PAPER No. 37: Household Financial Behavior: Implications For Consumer Spending
WORKING PAPER No. 38: Effects of Consumer Loan Rate Ceilings on Competition Between Banks and Finance Companies
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